

The impact of internal factors on costs: markets and customer satisfaction

GETTING STARTED

In a small group, think of an SME that used to offer products in your area but has now closed down. Discuss the factors that you think led to its closure.

'Costs' are everything an enterprise needs to pay for in order to produce, market and sell its products. Sometimes an enterprise can control its costs internally – as will be shown in this lesson and the next one. However, often costs are controlled or influenced by external factors, as will be discussed later on in this learning aim.

Understanding internal factors

Internal factors that affect costs can be controlled by an enterprise. These factors include, for example, how to understand the market it sells in and how to keep its customers happy. Happy customers lead to sales, which will balance out the costs an enterprise has.

Understanding the market

For an enterprise to be successful, it must understand the market it is operating in. It needs to know:

- what makes its products unique
- who its competitors are
- what its customers want.

LINK IT UP

To remind yourself of the creativity and innovation required by SMEs, and how important it is for an enterprise to understand its market to change for the future, go back to Learning aim A of this component.

ACTIVITY

- 1 a) In a small group, choose two of the following types of goods and services:
 - handmade greeting cards
 - dog walking
 - recycling plastic or glass bottles
 - pet photography
 - second-hand books and DVDs
 - ironing
 - vintage clothing
 - hair oil.

Make sure your group is considering different types to other groups.

- b) Carry out some basic research on the rest of your class members to find out if there is a market among them for your two chosen goods or services. Use the questions below to help you.
 - Would students in your class pay for any of these goods or services?
 - If 'yes', how much would they be willing to pay?
- 2 a) Explain how you would work out the size of the market in your area and online for any of these goods and services.
 - b) Using the list above, discuss with your group which market for new customers you think would be the largest.

One way an enterprise can learn about its market is through research. This will help it to find out which customers may want the goods that are being offered and whether there is a competitor selling these already, either locally or online.

An entrepreneur can use secondary research as:

- a useful way of identifying competitors
- a method to ensure there is space in the market for another enterprise.

Researching the market

Properly researching its market and competitors will allow a business to keep its costs down by:

- avoiding spending money on ventures that are unlikely to be successful
- establishing how much it can expect customers to pay for goods or services, compared to how much it will cost to provide them.

LINK IT UP

To remind yourself of what secondary research is and how it works, go back to Learning aim B of this component.

EXPLORING ENTERPRISES

For example, if an enterprise has an idea for a new product, researching to see whether similar products exist will mean it can judge the amount of potential competition before paying to produce goods.

Take a look at Figure 1.13, which shows a scenario where an entrepreneur might not have done sufficient research into their potential competitors.



Figure 1.13: Are all of these shops likely to survive in such a competitive market?

Keeping customers satisfied

Even in markets with a lot of competition (like the scenario in Figure 1.13), it is possible for an enterprise to succeed. As Table 1.9 shows, there are six ways an enterprise can outdo its competitors to keep its customers satisfied. This will help an enterprise to make a profit, manage its costs efficiently and be successful.

Table 1.9: Six ways an enterprise can outdo its competitors

1	Quality of product	Matching the quality of products to what customers are willing to pay is important. <ul style="list-style-type: none"> • If the quality is too low, the customer is unlikely to return. • If it is too high, the resulting higher price may put them off.
2	Price of product	Customers look for value for money. This does not always mean a product is cheap. It means the customer feels the product is worth what they pay for it.
3	Unique features and selling points	These are the elements that make the product different from what competitors are offering. Customers are often attracted by something that is new or different.
4	Customer service	Smaller enterprises can often provide more personal service or local knowledge.
5	Availability	Having products available at the right time can help to retain customers. <ul style="list-style-type: none"> • Customers who are unable to get what they want, when they want, may shop somewhere else if the product is widely available. • However, some customers may be prepared to wait if the enterprise sells something unique that cannot be bought anywhere else.
6	Convenience	Convenience could include: <ul style="list-style-type: none"> • offering a service in the evenings and at weekends, as well as during the day • having parking available close to the enterprise.

LINK IT UP

To remind yourself of how to compile a competitor analysis table, go back to Table 1.8 in Learning aim B of this component.

ACTIVITY

Think back to the first activity you did in this lesson.

- 1 Carry out research into the most popular market you identified.
- 2 Practise your skills at identifying the competition by producing a competitor analysis table. The information in your table will help you to answer the questions below.
 - a) How much competition is there in your area?
 - b) How much competition is there online?
 - c) If this type of enterprise was established in your area, do you think it would be successful? Why?

CHECK MY LEARNING

Make a list of the reasons why an enterprise needs to understand its market.

The impact of internal factors on costs: planning, financing and marketing

GETTING STARTED

A common business saying is 'cash is king'. Discuss what you think this means and how it is relevant to an enterprise.

ACTIVITY

Think about the saying 'If you fail to plan, then you are planning to fail'. In a small group, list the reasons why you think this is true for any SME. Share your answers with the class.

KEY TERMS

Demand is the amount of customers, or potential customers, actively wanting your goods or services.

Financing is finding money for something

LINK IT UP

To find out more about planning and financing a business, go to Learning aim B of Component 3.

The previous lesson looked at how an enterprise can control its costs through understanding the market and keeping its customers happy. This lesson examines how enterprises can manage their costs for planning, marketing and human resources.

Effective planning and financing

Many SMEs fail because they do not effectively plan how to produce and sell their product, even though the product itself may be a brilliant idea. This type of failure is due to internal factors – how the enterprise itself has operated – but can be avoided if the enterprise is willing to change how it works.

Effective planning

Effective planning includes:

- choosing how and when customer orders can be taken – for example, in person or online
- being organised in terms of time management and ensuring that stock is checked regularly
- making sure that bookings are placed correctly
- taking into account travelling time (for example, how long it takes to get from the office to a customer's home when offering a service such as dog walking) so that customers are not kept waiting.

Another way of planning is to work out how many customers want products at certain times of year – for example, for their summer holidays. Some services have high peaks in **demand** at certain points in the year and low demand at other times. An enterprise that plans for this can sell more products. It can also avoid:

- having *too much* stock at the wrong time of year, which could result in having to lower prices and, therefore, lose profit
- not having *enough* stock at the right time of year, which could mean losing out on sales and the opportunity to bring money into the business.

Effective financing

Planning the **financing** and how money flows into and out of an enterprise is also crucial for its success. Without money, an enterprise cannot buy the materials or stock it needs to trade and may have to close down. A business needs to consider how much it is spending, or will spend, on internal factors, including:

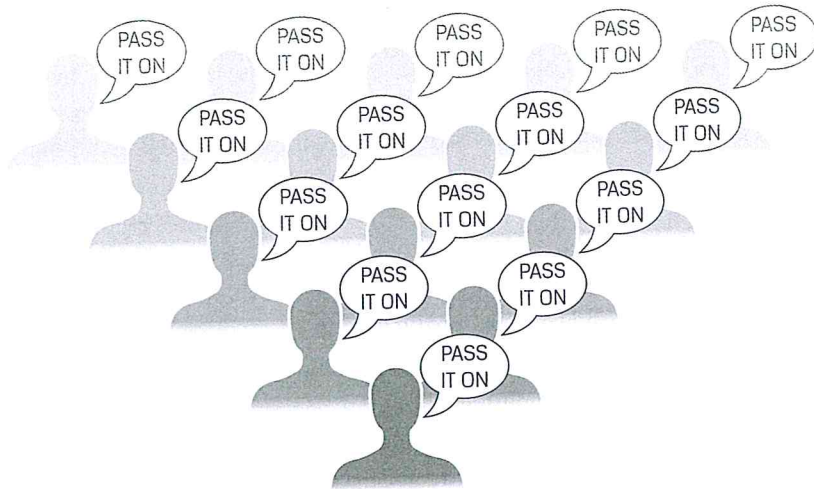
- paying staff their wages
- marketing and advertising.

These factors must be planned for and balanced against the money the enterprise is hoping to bring in.

Marketing and promoting the enterprise

Controlling marketing and promotion is another internal factor that an enterprise can manage itself. Some smaller enterprises do all of their marketing through word of mouth – see Figure 1.14.

Advertising and promotion can be very expensive. Smaller enterprises have to make sure the amount they are spending gives them value for money, by being effective in creating more customers and extra sales.



■ Figure 1.14: How do you think word of mouth could benefit an enterprise?

Social media platforms, such as Twitter and Instagram, make it possible for enterprises to advertise and promote themselves for free – for example, by sending out tweets or setting up feeds for customers to follow. It is also possible for enterprises to encourage customers to review and rate their goods or services online.

Unforeseen human resource costs

An enterprise always needs to have a **contingency plan** when it comes to human resources. In other words, it needs to:

- plan for the things it hopes will not actually happen – for example, a key member of staff being unable to work for several weeks because of illness
- have money available for unexpected costs – for example, having to pay someone else to help while the staff member is ill, while also continuing to pay the sick person's wages.

Sometimes a member of the enterprise's team may decide to leave their position for another job. If this happens, the enterprise will need to:

- advertise for a new team member
- ensure managers take time out of their busy schedule to interview new staff
- pay for any training requirements a new team member may have.

ACTIVITY

Read the following review that a customer has left on a review website for a small café owner.

Terrible service (1 star)

We ordered our food and ended up waiting for over an hour. All the other customers got their food and when our order finally arrived it had items missing. Our table was dirty. We had no knives or forks, salt or pepper. Not one member of staff came to check we were OK. There was no WiFi available and the drinks were very expensive.

How do you think the business owner should respond?



- Why might an enterprise need to reduce the price of its summer products?

DID YOU KNOW?

Social media sites such as Facebook offer SMEs the ability to do 'cost per click' advertising. This means an enterprise only pays for an advert when a customer clicks to look at the products, meaning that this is a highly cost-effective method of advertising.

KEY TERM

A **contingency plan** is a back-up plan for when things go wrong for an enterprise.

LINK IT UP

To find out more about contingency plans, go to Learning aim A in Component 2.

CHECK MY LEARNING

List three reasons why effective planning is important for an enterprise.

The impact of external factors on costs

GETTING STARTED

Sometimes an enterprise is affected by factors that are beyond its control. In a pair, think of three external factors that might affect any enterprise.

KEY TERMS

Interest is a percentage of the total amount of money lent, which is added to the amount that must be repaid.

Fluctuation is variations such as rises and falls in prices or costs.

DID YOU KNOW?

The price of oil can change daily, according to supply and demand. If the global price of oil rises, then the cost of electricity is likely to rise (become more expensive). If the global price of oil drops, then electricity prices are likely to drop as well. Use the internet to find out how much oil costs today compared with yesterday.

KEY TERM

Gross profit is the money made from selling a product (sales revenue) after the cost of sales has been deducted. It is calculated before tax has been taken off – profit after tax is called net profit.

LINK IT UP

To find out more about gross profit and costs, go to Learning aim B in Component 3.

As you have learned, an enterprise can control the effect of internal factors. However, this is not the case with external factors. When an enterprise is affected by external factors, it will need to work out quickly how to overcome them.

What happens when costs change

Enterprises can be affected by many different factors that they will not be able to control. These factors can help them positively, or can have a negative effect. You have already learned that effective planning and contingency plans can help an enterprise to overcome the impact of internal factors, which are individual to that enterprise. However, external factors may end up having an impact on many enterprises. An example of this is a rise (or fall) in costs, which includes things such as:

- energy costs – gas, electricity and oil
- costs of raw materials – the items an enterprise needs to produce its product
- the cost of borrowing money – the enterprise may have a bank loan that it pays **interest** on
- rates of renting premises – the enterprise may pay an individual or organisation to use the space it works in.

The rising and falling of costs is known as **fluctuation**. Enterprises need to be prepared for costs to fluctuate and should understand the effects this might have.

Raw materials

Raw materials are all the elements that go into making goods or offering services. They include anything that is needed to create the products or services that you are going to sell. Think of a flower stall owner. Their raw materials would include:

- the flowers themselves
- water to keep the flowers in, so they do not wilt or die
- wrapping paper, to wrap flowers in when they are sold.

Counting the cost of raw materials

Raw material prices are important because if they go up, costs go up too. Enterprises will always aim to make a **gross profit**. If their costs increase, but the amount they charge does not increase as well, they will make less money. This means an enterprise needs to be able to make adjustments to its prices, if necessary.

ACTIVITY

Imagine you are an entrepreneur making sandwiches. Your most popular sandwich is cheese and tomato and it sells for £1.50. To make each sandwich you spend: 10p on bread, 30p on cheese, 5p on butter and 20p on tomatoes. However, a recent global shortage of tomatoes means the cost has risen 25 per cent.

- 1 In a group, calculate:
 - a) the gross profit each sandwich made before the cost of tomatoes increased
 - b) the new gross profit each sandwich will make, due to the increase
 - c) the difference this increase in cost of raw materials makes, per sandwich.
- 2 Discuss with your group what you should do about the increase in the cost of raw materials. List your ideas.

Borrowing

An enterprise can sometimes borrow money from a lender such as:

- a bank
- a building society
- an investor.

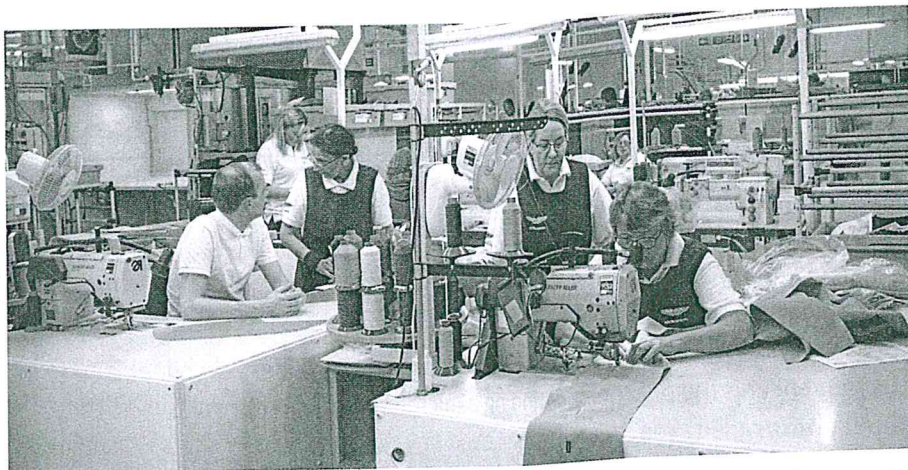
When an enterprise borrows money, it will pay an interest charge on the amount it has been lent. This is a percentage of the total amount of money, which is added to what it must pay back. However, interest rates can sometimes rise and fall, and these changes are beyond the control of an enterprise. They are external factors.

- If the interest rate goes down, then an enterprise will pay back less on the money it has borrowed (its **loan**).
- If an interest rate rises, then an enterprise will pay back more.

Premises

Many enterprises rent the space they work in. This means they pay an individual or an organisation for using their premises. Rent is often paid at least one month in advance. Like other external factors you have looked at, rent is often beyond the control of an enterprise. This means it can be raised by the owner, sometimes with very little notice.

Micro enterprises often trade from home to avoid these costs.



- If an enterprise's rent increases, why might it have to increase the price of its goods or services?

ACTIVITY

- 1 Carry out research to find examples of one of the following types of premises available for rent in your local area: industrial unit, retail shop or market stall.
- 2 Work out what would happen to an enterprise trading in each of these locations if it had the following increases in rent: one per cent, ten per cent and 20 per cent.
- 3 Discuss the questions below in pairs.
 - a) How likely would it be that the enterprise would need to raise prices?
 - b) What would happen if it did not raise prices?
 - c) What might happen if it did?

CHECK MY LEARNING

Make a list of all the raw materials that you think would be used by a bakery and a cleaning enterprise. Compare them.

KEY TERM

A **loan** is a sum of money borrowed that is expected to be paid back to the lender, usually with interest added on.

LINK IT UP

To remind yourself of the impact of a USP and customer loyalty, go back to Learning aim B of this component.

The impact of external factors: marketing, selling and regulations

GETTING STARTED

In a small group, make a list of all the marketing methods you can think of. Then choose an enterprise in your local area, and discuss which method you feel it would benefit from the most. Why do you think your choice is the best method? Which methods might be less successful?

ACTIVITY

- 1 Consider the types of marketing activity listed to the right of this activity. Add any other methods that you can think of to the list.
- 2 Choose three methods and research whether the costs have risen, decreased or stayed the same for each in the past three years. Note any forms of marketing that are free. You could complete a table that identifies the type of marketing and whether prices have risen, dropped or stayed the same in the past three years.

KEY TERM

Regulations interpret the law and state what people have to do to abide by the law.

As you have seen, fluctuations in costs are often external factors, beyond the control of enterprises, which can, nevertheless, have a big impact on them. This lesson looks at how marketing and selling are affected by rising costs, and what the law and regulations can mean for enterprises.

Changes in marketing costs

One of the vital tasks an enterprise will undertake is marketing its products. As with other costs you have read about, the costs of marketing and advertising may also rise. In these instances, enterprises will need to consider whether they can change how they do their marketing and advertising so that they can reduce costs. Generally speaking, enterprises will use the following sources to do their marketing. Some of these cost a lot of money, some are low cost and some are free:

- advertising on social media platforms
- advertising on other websites such as eBay
- using a blog
- flyers and brochures
- newspaper/magazine advertising
- vehicle advertising
- radio advertising
- email shots or campaigns
- trade shows
- business cards.

An increase in price for any these marketing methods will affect the the enterprise's gross profit.

Changes in selling costs

Costs of selling a service or goods can include the following.

- Paying the wages of everyone who helps to run an enterprise – even if an entrepreneur is the only person running a micro enterprise, they will still need to take a salary.
- Delivering the goods – for example, packaging and postage or courier costs.
- The cost of travelling – an enterprise delivering a service to the home (for example, a gardener) will need transport. Travelling costs include the transport itself, vehicle insurance, fuel and general maintenance of the vehicle.

Changes in government regulations

Some increases in price, such as the cost of motor insurance, happen because of an overall increase in the number of accidents. In these instances, the motor insurance industry has to pay by raising its charges. This means that buyers of insurance then have to pay more.

At other times, the UK government makes changes, usually on a yearly basis, to **regulations** that can increase the costs an enterprise must pay. Here are two examples.

Example 1:

The government sets an hourly rate on the minimum amount of money a business must legally pay its staff. When this amount rises, an enterprise will need to find the extra money to pay its staff the correct amount.

Example 2:

From 2018, the General Data Protection Regulations mean that businesses must store the personal data of their customers correctly to keep it safe. Setting up the new data protection system could cost an enterprise extra money. However, it will need to pay this cost in order to avoid breaking the law – if a business does not comply with this regulation, it could face a fine or the owner could be given a prison sentence.

DID YOU KNOW?

Employees younger than 25 are legally entitled to a minimum hourly wage. Employees over 25 are legally entitled to the National Minimum Wage. Use the internet to find out what both of these amounts are.

LINK IT UP

To remind yourself of how politics and social pressure as a whole can affect the way an enterprise operates, go back to Learning aim A of this component.

Changes in taxation

A third example of how government regulations can affect an enterprise is a change in **taxation**.

Governments set the amount of tax that is paid. This amount can change from one year to the next.

- An enterprise can generally earn a small amount of money without paying tax on it. This is known as an allowance.
- The enterprise then pays tax on everything above this amount.
- Enterprises and entrepreneurs pay National Insurance contributions on behalf of their employees and for themselves. National Insurance contributions go towards paying people's pensions when they retire and covering medical expenses provided by the NHS.

As with all the other cost increases you have learned about, any changes made by the government will eventually find their way to the customer. In other words, when a cost is raised, the fees an enterprise charges have to be raised to pay for it.

ACTIVITY

When direct taxes such as value added tax (VAT) increase, an enterprise has to pay higher costs for its raw materials or energy. This means that the price increase needs to be passed on to customers, via higher charges, or there needs to be a smaller difference between revenue and costs.

With a partner, consider the following questions.

- 1 What happens if the cost of raw materials goes up very quickly, at a time when customers cannot afford to pay higher prices?
- 2 If there is a VAT reduction, should an enterprise pass this saving on to the customer? If not, what else could it do?

CHECK MY LEARNING

Write a list of as many costs as you can think of that an enterprise has to pay. Consider what might happen to the enterprise if every one of these costs increased.

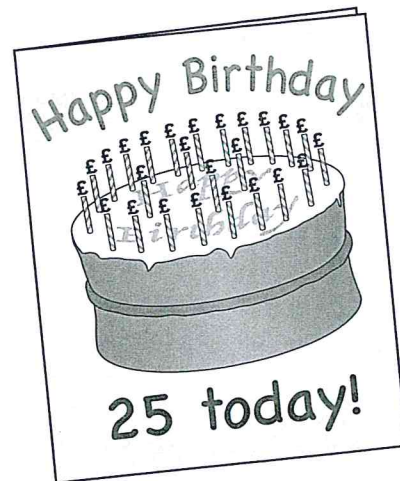


Figure 1.15: All employees aged 25 and over should be paid the National Minimum Wage under government regulations

KEY TERM

Taxation is the amount of money an enterprise or entrepreneur must pay the government each year. Enterprises and entrepreneurs are taxed on the amount of money they earn from running their business.

The impact of external factors on revenue

GETTING STARTED

In a pair, discuss the following questions.

- 1 How much would you be prepared to pay for a pair of jeans?
- 2 Would you have a minimum or a maximum price limit? Why?
- 3 What would you do if a new enterprise arrived in your neighbourhood, selling jeans for £5?
- 4 Would you buy them over another pair of jeans?

LINK IT UP

To remind yourself of the reasons enterprises fail, and why they need to make a profit, go back to Learning aim A of this component.

DID YOU KNOW?

One thing that is likely to attract new customers to an enterprise is its location – especially if a customer can reach it easily by public transport or park their car nearby.

ACTIVITY

Carry out research into the most successful SMEs in your area. Try to answer these questions:

- 1 How many competitors do they have?
- 2 What is their pricing – the same as others, higher than others or lower than others?
- 3 Where are they located?
- 4 Why are they successful?

'Revenue' is how much an enterprise earns from selling its goods or services. Just like costs, this income can also be affected by external factors that an enterprise cannot control.

Changes in revenue

Changes in revenue happen when the amount of money an enterprise receives goes up or down because of something happening outside the enterprise. It is not always possible for an enterprise to stop or influence others making changes. However, how it responds to changes is very important.

Competitors

As well as having to consider rising costs and how this impacts on the price of products, an enterprise needs to know what its competition is doing. This might be:

- existing competitors the enterprise already knows about
- new enterprises coming into the market.

A new enterprise can have an impact on an existing enterprise by attracting its customers – for example, by running promotions or special offers that are appealing. Existing competitors may also decide to run special offers to try and gain customers from other businesses.

Competition can sometimes become very fierce and turn into a price war, with enterprises trying to outdo one another by offering the lowest possible price. This could lead to problems, or even failure for some of the enterprises, because lower prices mean lower revenue for the businesses involved. Reduced revenue will affect cash flow and can leave businesses struggling to pay bills. Figure 1.16 shows what can happen in a price war.

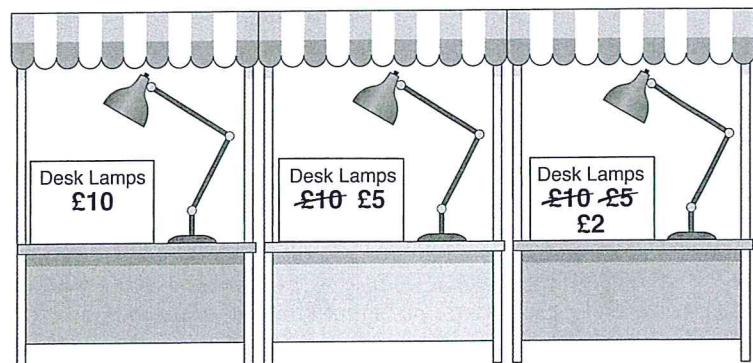


Figure 1.16: Can you think of any recent price wars that have been in the news?

Consumer confidence

Consumer confidence means the confidence that existing and potential customers have in the UK **economy**.

If the economy is experiencing **growth** (doing well) and most people have jobs, consumers are likely to:

- feel confident about the future
- spend their money – which leads to increased sales for enterprises.

EXPLORING ENTERPRISES

If the economy is experiencing a **recession** (doing badly) consumers are likely to:

- lose confidence about the future
- worry about whether their jobs are safe
- only spend money on essential things, which can lead to lower sales for enterprises.

DID YOU KNOW?

Some products are affected by consumer confidence more than others. During a recession, when confidence is low, expensive and luxury products such as jewellery sell less well. However, during growth periods, when confidence is high, sales of luxury goods increase.

Consumer behaviour

Consumer **tastes** can have a big impact on sales. For example, trends in fashion can show what is and what is not popular at a certain time. Many consumers will not buy things that are not 'on trend'. This is a form of social pressure that can affect many kinds of enterprise.

An enterprise may open a new business when consumer demand is high for a particular product – for example, an electronic gadget that everyone wants. However, when consumer tastes change, and the gadget is no longer popular, the enterprise will either have to change and adapt, or risk failing.

ACTIVITY

Between 2010 and 2012, there was a high demand for fish spa treatments. Many salons opened all over the UK and they became very popular. However, this trend only lasted for a short amount of time.

- 1 Working individually, find out more about fish spa treatments, why they became popular and why they closed again.
- 2 In a group, create a list of any other enterprise ideas you can think of that started, were very popular and then closed due to loss of popularity.

Consumer legislation

The final external factor that can have an impact on revenues is any change in **legislation**. Sometimes things that have previously been allowed are:

- banned – they are no longer permitted to exist
- changed in terms of how they can be used or sold – for example, how goods can be packaged
- changed in terms of how they can be advertised or promoted.

Such bans and changes can have a considerable impact on sales. Customers may stop buying something because of a change in the way it is labelled or displayed. Similarly, if a product is banned, it becomes illegal to buy or sell it without facing serious consequences.

CHECK MY LEARNING

Explain the difference between consumer confidence and consumer behaviour. Give one example of each.

KEY TERMS

Economy is the system by which a country's money and goods are produced and used.

Growth is when the number and value of goods and services produced in an economy is going up. This usually results in consumer confidence.

Recession is when the number and value of goods and services produced is going down. This may be followed by a lack in confidence and people buying less because they are concerned about the future.

Tastes are the trends or fashions that a consumer may follow, relating to what they like, dislike and are interested in.

Legislation relates to the laws of a country, which everyone must obey.

LINK IT UP

To recap your knowledge about social pressures influencing enterprises, look back at Learning aim A of this component.

DID YOU KNOW?

In the UK, tobacco goods can no longer be publicly displayed and their packaging has been changed. In 2007, the legal minimum age to buy cigarettes was also increased from 16 to 18. These changes were made to try to discourage customers from buying them.

GETTING STARTED

List all the internal and external factors you can think of that can affect an enterprise. Compare your list with others in the class.

Understanding situational analysis: SWOT

Situational analysis literally means the process of analysing (or studying) a situation. An enterprise that uses situational analysis will be able to study its position in the market, and assess how it could be affected by trends and developments.

SWOT analysis

There are two common tools an enterprise can use to help it make a situational analysis. The first one is known as SWOT and the second is known as PEST. In this lesson, you will look more closely at SWOT.

SWOT stands for:

Strengths
Weaknesses
Opportunities
Threats.

How to carry out a SWOT analysis

An enterprise will be able to use a SWOT analysis when it has identified all the internal and external factors it needs to review (much like you did in the 'Getting started' activity). The analysis will help the enterprise to make judgements on how each factor can have an impact on it.

A SWOT analysis can be made using a table like the one shown in Figure 1.17. The enterprise lists all the internal and external factors it has identified and decides whether they are strengths, weaknesses, opportunities or threats. Here are some examples.

Strengths

Strengths are things the enterprise is very good at. They could include:

- maintaining a high number of customers
- having a good reputation
- offering quality service.

Weaknesses

Weaknesses are areas where the enterprise needs to improve. Examples of these could include:

- lack of training provision for staff
- not enough resources that would improve trade
- goods or services that are not selling as well as others.

Opportunities

Opportunities are developed from both the strengths and weaknesses of the enterprise, and aim to set out ways that the enterprise can consider new areas or aspects to improve on. If a product is not selling well, there is an opportunity to offer a different one or consider stopping selling it altogether. If an enterprise is good at something, an opportunity could be to start selling in a new location or to new customers.

Threats

Threats are anything that is likely to prevent the enterprise from being successful. Examples include:

- changes in customer taste
- new competitors entering the market
- existing competitors changing what they are doing or increasing their marketing
- existing or new competitors lowering their prices to negatively affect the enterprise.

DID YOU KNOW?

A SWOT analysis can be applied to every type of SME. It is often included in business plans when considering the future of the enterprise. SWOT analysis could be used to think about specific areas of the business that might require extra finance, or to consider ideas for marketing. (A business plan generally also includes information about finances, marketing and human resources.)

The café in Figure 1.17 lists many more strengths and opportunities than it does threats, which suggests the enterprise is doing well. It looks as though it currently has a **competitive advantage**. If an enterprise has too many weaknesses or threats, it is likely to be at a disadvantage and will need to do something to change its situation.

One thing all enterprises need to remember is that a SWOT analysis is only useful if it is done regularly and updated to show any changes that have happened. If a SWOT analysis is out of date, it will not be helpful going forward.

<i>Strengths</i>	Excellent customer service. Very loyal customers. 5 star hygiene rating from local council. Experienced staff working at the café for more than two years. Only café on the high street offering scones and jam. Good reputation locally. Excellent advertising with a local magazine, with high take-up of special offers and vouchers. Value for money prices.
<i>Opportunities</i>	Increase the number of tables in the café by taking over the empty shop next door. Increase the number of tables by rearranging the furniture to make best use of space. Recruit another weekend cook to reduce waiting times. Include new types of cakes and pastries to increase the number of customers.
<i>Weaknesses</i>	Not enough tables available on a Saturday morning, due to high numbers of customers. Waiting times can be 30 minutes at busy times, due to having only one cook.
<i>Threats</i>	The empty shop next door may be taken by another café and this could affect customer numbers. A new restaurant is opening at the other end of the high street and this may affect trade. Other cafés may start offering scones and jam.

Figure 1.17: A completed SWOT analysis for a small café. How well do you think this enterprise is doing?

ACTIVITY

- 1 In a small group, choose two local enterprises you know well that are in very different industries. Complete a SWOT analysis for each enterprise, making sure you include as much information as possible.
- 2 When your SWOT analysis is complete, share it with another group to exchange ideas and compare what you have found out.

KEY TERM

Competitive advantage is the advantage gained by offering superior goods or services to those of competitors or offering cheaper prices.

CHECK MY LEARNING

Write out what SWOT stands for. Then note down briefly why it is important for an enterprise to use this tool regularly.

GETTING STARTED

Think about all the political, economic, social and technological aspects you have learned about that affect enterprises. List as many as you can remember, then share your list with others in your class to create a class mind map of all these factors.

LINK IT UP

To remind yourself about political and social pressures, go back to Learning aim A of this component.

LINK IT UP

To remind yourself about external factors, go back to the lessons 'The impact of external factors on costs', 'The impact of external factors: marketing, selling and regulations' and 'The impact of external factors on revenue' in this learning aim. These can all be used to form a PEST analysis.



- ❑ How do you think apps to book a table at a restaurant could help an enterprise?

Understanding situational analysis: PEST

The previous lesson looked at how an enterprise can benefit from using a situational analysis tool called SWOT. Now you will take a look at a situational analysis tool known as PEST.

PEST analysis

PEST stands for:

- **P**olitical
- **E**conomic
- **S**ocial
- **T**echnological.

An enterprise will be able to use a PEST analysis when it has identified all the internal and external factors it needs to review. This analysis will help the enterprise to make judgements on how each factor identified can have an impact on it. Many of the factors identified in a PEST analysis are likely to be external.

How to carry out a PEST analysis

A PEST analysis can be made using a table like the one shown in Figure 1.18. The enterprise lists all the factors it has identified and categorises them as either political, economic, social or technological.

Political

Political influences include:

- any changes or factors happening with government policies and laws
- any changes in government, such as a new leader of a political party being appointed
- the effect of pressure groups
- the effect of wars
- the effect of taxation
- the effect of changes in the environment
- relationships with other countries
- factors relating to the European Union (EU), especially as the UK undergoes the process of leaving it.

Economic

Economic means factors that relate to the economy as a whole, such as:

- employment levels
- exchange rates, which can change the price of raw materials
- wage levels
- interest rates, that enterprises may have to pay for loans
- the amount of money people in the UK have to spend.

Social

Social is anything to do with lifestyles, cultures and how people spend their time.

This could include:

- changes in trends and fashion
- ethical concerns – for example, buying Fairtrade goods

- environmental concerns – for example, the impact some products can have towards climate change
- welfare concerns – for example, thinking about how farm animals are cared for
- customer demographics - for example, their typical age and whether or not that age group is increasing, gender and potential growth of that gender in purchasing
- attitudes towards work and jobs affecting income
- education - the level of education of customers and how this affects sales.

Technological

Technology changes all the time. Enterprises need to consider how technological changes might affect them in the future and what they can do to keep up with these changes. Technological factors include:

- developments in computers and the internet
- developments in mobile technology, such as smartphones
- the introduction of machines to replace human workers, such as self-service checkouts in supermarkets
- increases in the amount of online buying.

Some of these factors might overlap and fall into more than one category – for example, an increase in the purchasing of eBooks could be due to both technological and social changes. It is important for enterprises to be aware of all of these kinds of changes and how they might affect their business.

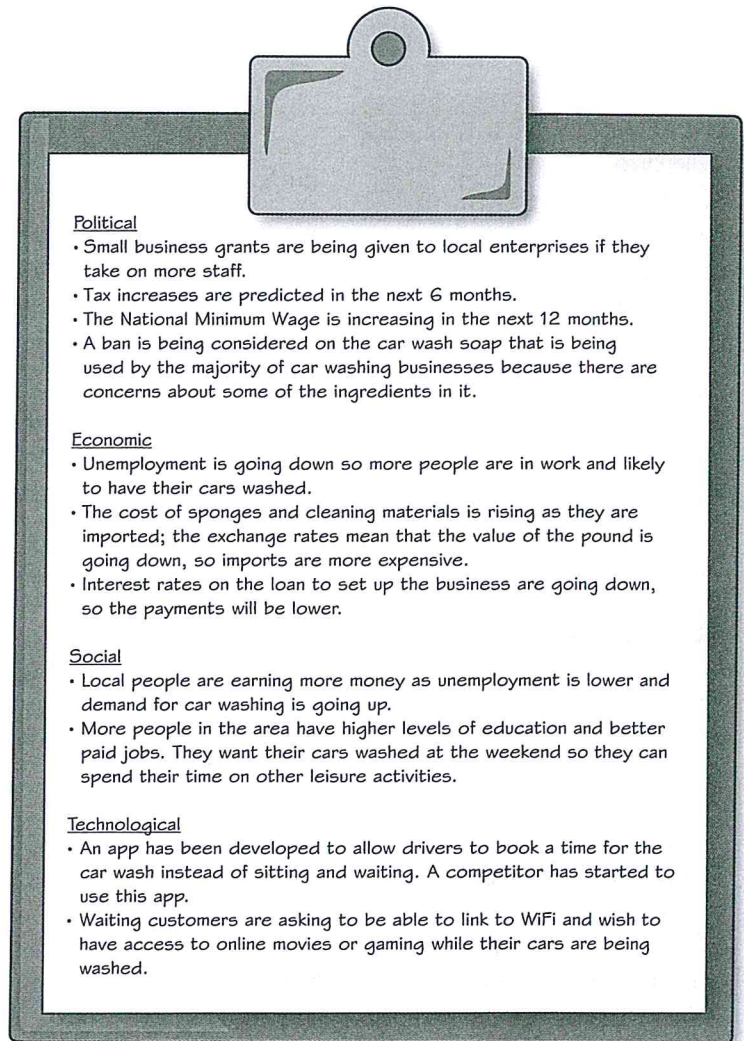


Figure 1.18: A completed PEST analysis for a car wash business. What does this enterprise need to think about for its future?

ACTIVITY

Carry out a PEST analysis for the two local enterprises you reviewed in the previous lesson (for your SWOT analysis). Compare how each of the enterprises is affected by the factors you identify. Use the following questions to help you.

- 1 Is one enterprise more affected than the other?
- 2 What does this mean for the future of the enterprises?
- 3 What can they do to make sure the impact of these factors is positive?

CHECK MY LEARNING

Explain what PEST stands for. Outline how it can be used to help an enterprise understand more about the external factors affecting the way it operates.

DID YOU KNOW?

There used to be enterprises that offered a delivery service for films. A customer could select a film on video or DVD, which the company would then post to the customer's home or even deliver in person. New technology means films are now mainly streamed online. How do you think this has affected the people who used to work for these enterprises?

GETTING STARTED

Think back to the start of this component and the aims that all enterprises have. Write a list of those aims. How many can you remember?

ACTIVITY

Think back on what you have learned so far about the reasons why enterprises fail.

- 1 In a small group, discuss why you think enterprises are able to survive for one year but might struggle or fail after five years. Consider cash flow, competition, reputation, industry and other factors you have come across in this component.
- 2 Share your thoughts with other groups to create a class mind map outlining your ideas.

LINK IT UP

To remind yourself of the different ownership types and how they are defined, go back to Learning aim A of this component.

LINK IT UP

To remind yourself how enterprises can satisfy the needs of customers, go back to Learning aim A of this component.

Reasons an SME is successful

As you will have seen throughout this component, there can be many reasons for the success, or failure, of an SME. However, the main reasons come from the aims it sets out to achieve.

LINK IT UP

To remind yourself about setting objectives and aims in order to achieve something, go back to Learning aim A of this component.

Top four aims

Many SMEs have common aims. The top four are:

- surviving
- breaking even
- making a profit
- meeting customer needs.

In this lesson, you will take a look at each of these in turn.

Surviving

Survival means continuing to operate for a long time – four to five years is a common benchmark – after the enterprise started. About 90 per cent of small businesses survive their first year. However, after five years many of these enterprises begin to struggle. Generally, only 40 per cent will still be running at this point.

Breaking even

Breaking even is the point at which an enterprise can evenly balance its costs and revenue. The enterprise is not making a profit, but it is not making a loss either. For some new enterprises just getting to this point is a success, especially if they are in their early years and hoping to build up a customer base for the future.

LINK IT UP

To learn more about how to work out break-even, and the calculations of costs and revenue that relate to this, go to Learning aim C of Component 3.

Making a profit

An enterprise will generally want to make a profit. Profit is the amount of money left over after all the costs have been taken away from all of the revenue (income). Making a profit is an essential measure of success for most privately owned enterprises. In fact, it is the key reason many enterprises trade. For social enterprises, this profit is called a surplus. The surplus is reinvested in the venture or given to charity in order to help causes the enterprise feels are important.

Meeting customer needs

A further measure of success is that customers are happy and satisfied. Meeting the needs of customers ensures they remain loyal to the enterprise and keep buying from it.

Reasons for the success of SMEs

As well as thinking about their original aims, SMEs are often successful due to hard work, high levels of resilience and **perseverance**. Take a look at Figure 1.19, which offers some more reasons.

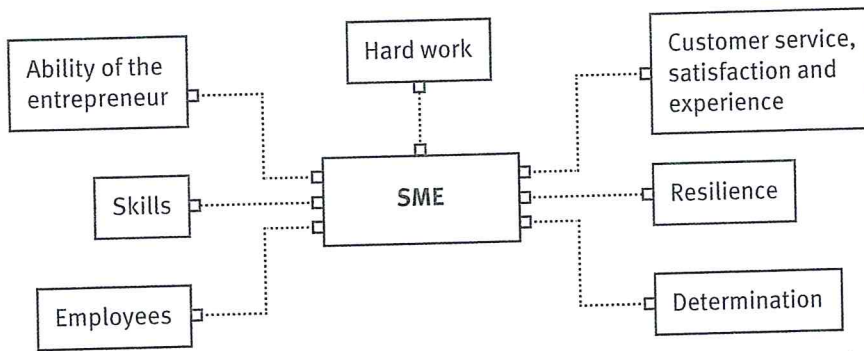


Figure 1.19: A combination of many different elements will increase an enterprise's chance of success

KEY TERM

Perseverance is not giving up and continuing to work at something, despite difficulties encountered along the way.

ACTIVITY

- Choose three successful micro or small enterprises in your area. Try to answer these questions about each one.
 - What makes these enterprises successful?
 - Why do customers use them?
- Check against each of the elements in Figure 1.19 to see what each enterprise does that matches these areas of success.

Maintaining success

Even when an SME reaches a point at which it considers itself a success, it will need to continue working hard to ensure it stays that way. Some methods of maintaining success are shown in Table 1.10.

Table 1.10: How an SME can maintain success

Area	Maintaining success
Motivating, developing and training employees	Employees in smaller enterprises often have more responsibility and are relied on to help the business grow. Motivating them and making sure they have the highest level of training are key reasons for success, now and in the future.
Customer service and satisfaction	Good customer service helps any enterprise to be successful. An SME should continue to monitor its customer service and satisfaction to keep it at a high level.
Experience of operating in that market or similar markets	Enterprises that are successful often have experience of working in the market. An entrepreneur may already have had market experience before they joined the enterprise, and so bring this knowledge to the role. Staying in touch with how the market(s) operate, and being aware of any new or potential changes, will help the SME in the future.

CHECK MY LEARNING

Explain the difference between breaking even and making a profit. Then explain why this difference is important.

GETTING STARTED

Based on what you have learned so far, think about how an SME can measure its success. Write a list of three ways it might be able to do this.

Measuring the success of an SME

Knowing what success means is just one part of being successful. Being able to measure success will allow an enterprise to understand what it does well, any changes it might need to make and what it should endeavour to do in the future.

Methods of measuring success

There are six key ways in which success can be measured, as Figure 1.20 shows.

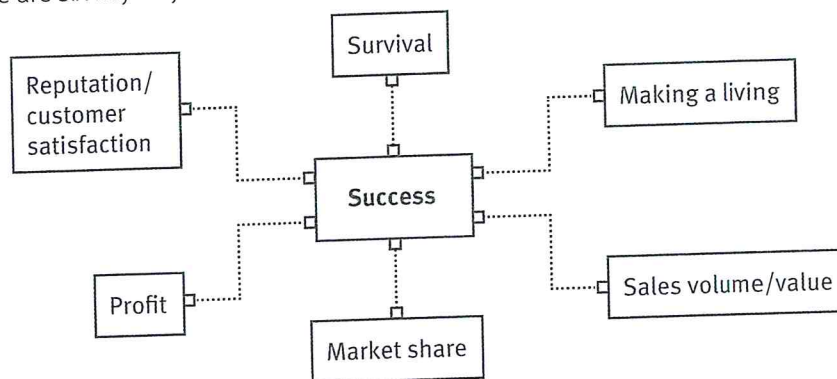


Figure 1.20: How do you think measuring success in these six key ways can help an enterprise?

LINK IT UP

To reflect on the reasons why entrepreneurs start their own businesses, go back to Learning aim A of this component.



How could you gauge this enterprise's success?

KEY TERM

Market share is the proportion of all the sales of a group of related goods or services that an enterprise makes when calculating the total 'market' for that group of products. The total market is calculated by adding together the sales made by the enterprise and all of its competitors.

Method 1: survival

Measuring survival is based on the number of years an enterprise has traded. You have already learned in an earlier lesson that the first five years of business are usually the most challenging. The longer an enterprise trades for, the more successful it has been.

Method 2: making a living

You have learned about the many reasons why an entrepreneur starts up their business. Often, one of their main goals will be to create a comfortable and happy life for themselves and their family. Being able to provide for the family and make money shows the enterprise is a success.

Method 3: sales volume/value

The number of customers and value of those customers are also measures that demonstrate success.

- The sales volume is the *number* of sales that have been made. These can be measured through the number of customers or transactions taking place.
- The value is the *amount* each customer spends. The higher the value, the more likely it is that the enterprise is doing well.

Enterprises often have the objective of increasing the value of sales per customer. This is one way to be even more successful. It is often easier to encourage a customer who already knows the enterprise to spend more, rather than trying to gain a new customer.

Method 4: market share

Market share is the percentage of a market that an enterprise controls. For example, if an enterprise has £10,000 worth of business per year of the car washing market, in an area where the market is worth £100,000 a year, they have ten per cent of that market.

ACTIVITY

- 1 Find out the value of a market of your choice in your area.
- 2 How large is that market?
- 3 How many enterprises operate in that market?
- 4 Work out the market share that each enterprise has.

DID YOU KNOW?

According to the Management Consultancies Association, the management consultancy market in the UK is worth around £10 billion and, of this, 28 per cent is technology consultancy.

Method 5: profit

Measuring profit shows the success of an enterprise. There are many different **liquidity ratios** you need to know to be able to measure this. As profits go up, the enterprise is demonstrating success.

However, it is also important for it to have enough cash available. An enterprise can sometimes find itself in a situation where, even though it is making healthy profits in the long term, there is not enough cash in the bank in the short term. This would usually be because it has had to pay for things like raw materials and the energy needed to run the enterprise before its customers have paid for their goods or services.

LINK IT UP

To find out more about the many different ways to measure liquidity and profitability, go to Learning aim B of Component 3.

Method 6: reputation/customer satisfaction

Measuring customer satisfaction and the reputation of the enterprise can help an SME to work out if it is successful or not.

- If the enterprise is doing well, it is likely to have a good reputation and customers will tell their friends and family to buy there or use its services.
- If customers are unhappy and tell others, it may lead to them avoiding the enterprise. This could lead to sales going down and cause serious problems for the business.

ACTIVITY

- 1 In a pair, choose a local enterprise. Produce a survey, or other method of collecting primary research, to measure customer satisfaction for that enterprise and think of a way to measure its reputation.
- 2 With your partner, use your survey to collect data about the enterprise. Share your findings with your class.
- 3 As a class, discuss the following questions.
 - a) How easy was it to do this task?
 - b) How useful was your data?

CHECK MY LEARNING

List three different methods of how an enterprise can measure success. Explain how an enterprise would know whether or not it was successful from these methods.

KEY TERM

A **liquidity ratio** shows how easily an enterprise can pay its bills through cash, or other things it owns that can easily be turned into cash, as a ratio, compared to how much it owes (debts) in the next year. Cash and debts should be at least equal or, ideally, there should be more cash available than debts; for example, 2:1.

LINK IT UP

To remind yourself of the methods that could be used to collect primary and secondary research on how customers feel about products, go back to Learning aim B of this component.

Learning aim C: assessment practice

How you will be assessed

Now that you have studied the topics in Learning aim C, you will be able to show that you understand the many different internal and external factors that affect whether or not an enterprise is successful.

You will take what you have learned and explain the ways in which internal and external factors are important for all enterprises. You will then do the same for one enterprise in particular. For your chosen enterprise, you will need to analyse how these factors have helped to influence or determine the success of that enterprise. You will make judgements, based on your findings, about how these factors are currently affecting that enterprise.

CHECKPOINT

Strengthen

- Name two internal factors that affect the success of an enterprise.
- Name two external factors that affect the success of an enterprise.
- State what is meant by unforeseen human resource costs.
- List the ways that an enterprise can be affected by changes in the cost of energy or raw materials.
- Explain two changes that a government can make that can affect the success of an enterprise.
- Give an example of how consumer confidence can positively affect an enterprise's success.
- Explain what is meant by a SWOT analysis and a PEST analysis.

Challenge

- Explain why high levels of resilience might be more important than experience for an SME.
- Give a judgement on how useful measuring market share would be to an SME in a very large industry.
- Explain what is likely to happen if an enterprise develops a reputation for having poor availability of stock and poor customer service.

TIPS

Make sure you choose an enterprise you know well, as you will need to complete a PEST analysis and a SWOT analysis to help you make judgements about success.

EXPLORING ENTERPRISES

ASSESSMENT ACTIVITY

LEARNING AIM

C

Choose one enterprise that you are going to research in detail and think of other examples that you can write about. Remember, the enterprise you choose needs to be a small or medium enterprise.

In the earlier part of this assessment activity, you should include as many examples as you can from enterprises to make your answer as clear as possible. However, in the later stages of your work, you should focus much more specifically on your one selected enterprise.

- Identify what is meant by internal and external factors and the difference between them.
- Describe the internal and external factors that are important for an enterprise's success, in general. Ensure you include why these factors, both internal and external, are important. Where you can, provide examples from your learning to explain your answers.

Now, apply what you are explaining to one selected enterprise. You need to be able to analyse how and why the internal and external factors have led to the success of that enterprise in particular.

- Apply the PEST analysis and the SWOT analysis to help you make judgements about these factors.
- Give a judgement about the most important internal and external factors that are currently affecting that enterprise. Explain the impact these are having on the success of that enterprise.

TAKE IT FURTHER

Check through your answers to make sure you have looked clearly at the measures for success and how they were chosen by that enterprise. Knowing what the enterprise set out to do, and then measuring if it has achieved or exceeded expectations, will help you to make a judgement about its success.

TIPS

Remember, throughout your assessment activity, you should include several examples of businesses that you have learned about on your course to help make your answers as clear and well explained as possible.