



Edexcel A2 Business

2.5.1 Economic Influences

Revisionstation

From Edexcel

a) The effect on businesses of changes in:

- inflation (the rate of inflation, the Consumer Prices Index)
- exchange rates (appreciation, depreciation)
- interest rates
- taxation and government spending
- the business cycle

b) The effect of economic uncertainty on the business environment

Worksheet

2.3.1 Economic influences

Recession/slowdown

Winter

Starters

Write a definition of economic influence here

This effect on business of changes

Inflation

What is inflation?



How is business affected by changes in inflation?

Exchange rates

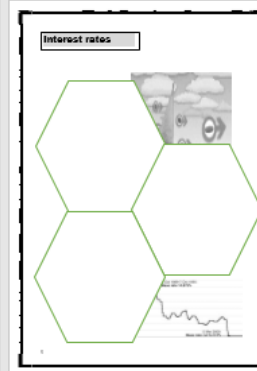
Exchange rates

Exchange rates: appreciation

Exchange rates: depreciation

Depreciation of the Pound

Appreciation of the Pound



Taxation

What is taxation?

How is business affected by changes in taxation?

Taxation and GDP

GDP taxation for small businesses

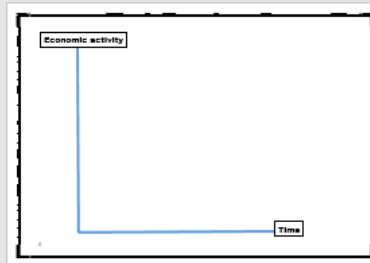
GDP taxation for larger businesses

GDP taxation: indirect taxes

Government spending

Write a definition of economic influence here

Write a definition of economic influence here



The business system

Write a definition of economic influence here

Business uncertainty

Write a definition of economic influence here

Research

Young Scotland Limited is the leading UK and Ireland provider of youth and young people's services. It is a not-for-profit organisation with a mission to provide young people with the skills, knowledge and experience they need to succeed in the world of work.

	Year ended December 2013	Year ended September 2014
Revenue	£10.1m	£10.1m
Operating profit	£2.1m	£2.1m
Operating profit margin	20.8%	20.8%

Source: Young Scotland Limited financial statements

Explain how inflation could have impacted the profitability of Young Scotland Limited

Research

How might 'lean production' be implemented?

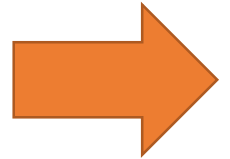
Write a definition of economic influence here

Explain how inflation could have impacted the profitability of Young Scotland Limited

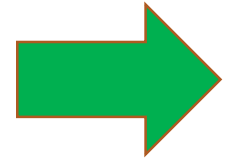
Starter: match the words and arrows

Inflation

Falls

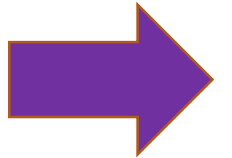


Costs



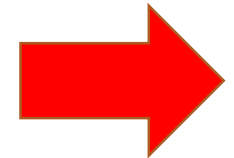
Rises

Profit Margin



Rise

Profitability



Falls

Economic influence defined

- Economic influence is when a business is affected in any way by economic factors e.g. inflation, exchange rates etc.



The effect on businesses of changes

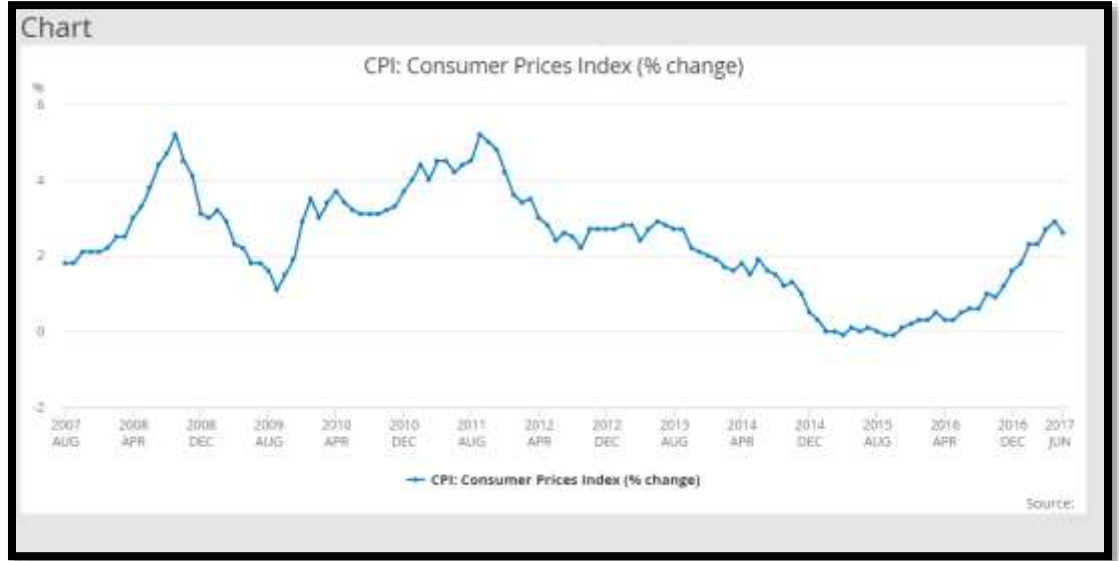
What is inflation?

- Ever noticed that goods now are more expensive than when you were younger? This is inflation at work.
- The annual rate of inflation shows how much higher or lower prices are compared with the same month a year earlier. It indicates changes to our cost of living
- The inflation rate is the rise in the price of goods in the UK economy
- Deflation would be a fall in the general price level
- Inflation is measured using the CPI (see next slide)



CPI is the Consumer Price Index

- CPI looks at the prices of hundreds of things we commonly spend money on, including bread, cinema tickets and pints of beer - and tracks how these prices have changed over time.
- The inflation rates are expressed as percentages. If CPI is 3%, this means that on average, the price of products and services we buy is 3% higher than a year earlier.



What is CPI?

- Consumer price inflation is the rate at which the prices of goods and services bought by households rise or fall.
- A convenient way of thinking about this is to imagine a very large 'shopping basket' containing those goods and services bought by households.
- As the prices of the various items in the basket change over time, so does the total cost of the basket.
- Movements in consumer price inflation indices represent the changing cost of the shopping basket.



How is business affected by changes in inflation?

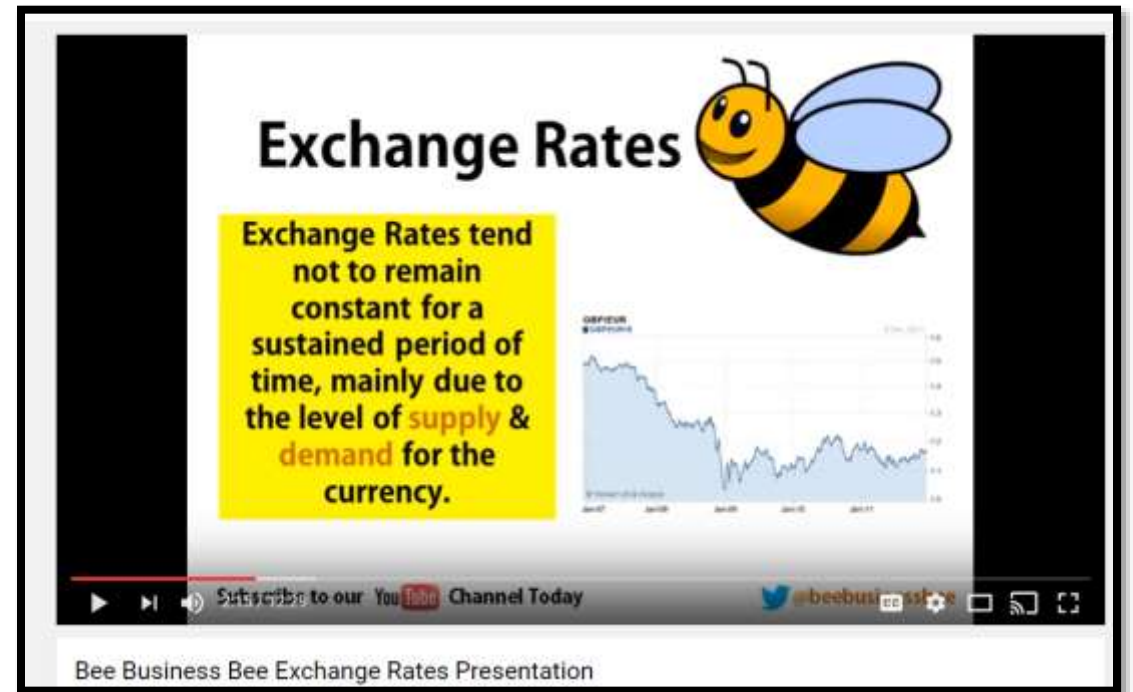
- As inflation rises so does the cost of products and services
- Cost of supplies, ingredients and raw materials will go up
- As costs go up due to inflation, business owners may need to increase their prices to maintain profitability
- Profit margins will be squeezed



Cake maker on food inflation: The prices keep going up

What are exchange rates?

- The exchange rate is the price of one currency in exchange for another
- You may have “changed” your money up for a holiday abroad, and you will have been charged commission to do so
- Currencies can change in value and this is due to the demand and supply of a currency



Exchange rates - appreciation

- Appreciation means that there is a rise in the £pound against other currencies means the £pound can buy MORE foreign currency
- This may also be called a high value or strong value of the pound
- Strong pound means that imports will be cheaper and exports will be dearer

UK's factories hamstrung by strong pound

The strength of sterling has hampered the manufacturing sector's attempts to gain ground in July



The UK's manufacturers reported stronger demand in July, but exports fell Photo: ALAMY

SPICED

- When the pound is strong UK businesses that import from abroad will have cheaper costs e.g. a restaurant that imports Italian wine will have lower import costs
- When the pound is strong businesses will find it harder to export UK made goods abroad as they will appear more expensive to other countries e.g. Raleigh bikes made in UK

Strong
Pound
Imports
Cheaper
Exports
Dearer

Exchange rates - depreciation

- A fall in £pound is called depreciation
- UK decision to leave the EU meant that the £pound fell sharply against other currencies
- This is bad news for UK tourists as their money will be worth less abroad
- This is also bad news for any UK businesses that import goods and services



How is business affected by changes in exchange rates?

- First you need to find out in the question if the pound is stronger (appreciated) or weaker (depreciated) against other currencies

Appreciation of the £pound

Strong

Pound

Imports

Cheaper

Exports

Dearer

Depreciation of the £pound

Weak

Pound

Imports

Dearer

Exports

Cheaper

- Then find out if the business imports or exports, use SPICED to work out if the business costs will rise or fall

Interest rates and the Bank of England

- Interest rates means the cost of borrowing money
- The Bank of England is now responsible for deciding what the interest rate should be in the UK
- If the bank of England pushes up interest rates consumer and business spending will fall
- The bank of England will raise interest rates if inflation is high and lower them if inflation is not a problem within the economy
- Lower interest rates encourage economic growth and a fall in unemployment



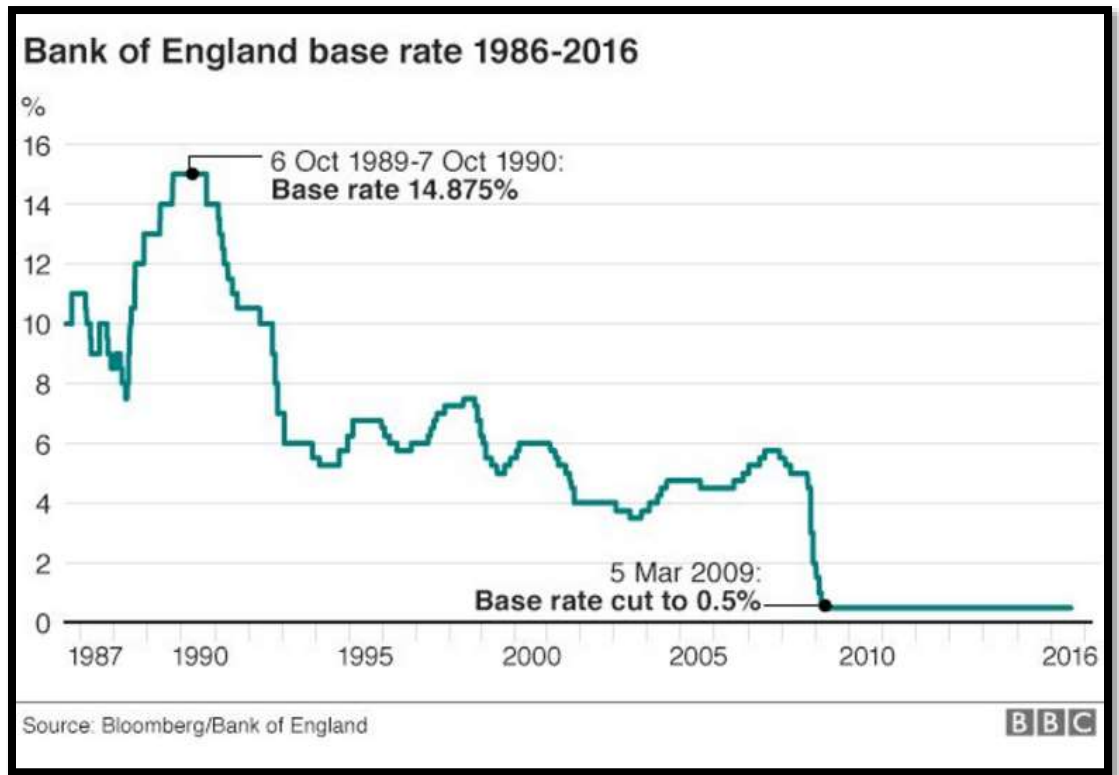
Interest rates – cost of borrowing

- If interest rates on a loan are low then consumers may borrow money to buy; a car, sofa, holiday etc.
- If interest rates go up then consumers will not borrow and so will save instead of spending, this is bad news for UK businesses that sell cars, sofas and holidays



How is business affected by changes in interest rates?

- If interest rates rise then the cost of borrowing will rise and this will mean that the cost of supplies for a business may increase
- A fall in interest rates means that the cost of lending falls which may lead to an increase in profits (costs less to borrow so less to pay back)



What is taxation?

- The government can change the way businesses work and influence the economy either by changing taxes
- These are announced each year in the budgets (see short video)



How is business affected by changes in taxation?

- Lower **taxes** can result in more demand in the economy and lead to higher output and employment
- If taxes are high then UK businesses will have higher costs
- This makes them less competitive in a global marketplace
- It may also mean unemployment rates may rise as businesses have to lay off extra staff due to the reduction in demand



Can you guess which items we pay VAT on – pay the BBC game above

Taxation and VAT

- If the % of VAT goes up a business could pass this cost on to the consumer so it makes goods more expensive to buy, or absorb the cost which will have an impact on their profit margin
- In 2011 the rate of VAT was 17.5% and it is now 20%

1. How VAT works

! You can only charge VAT if your business is registered for VAT.

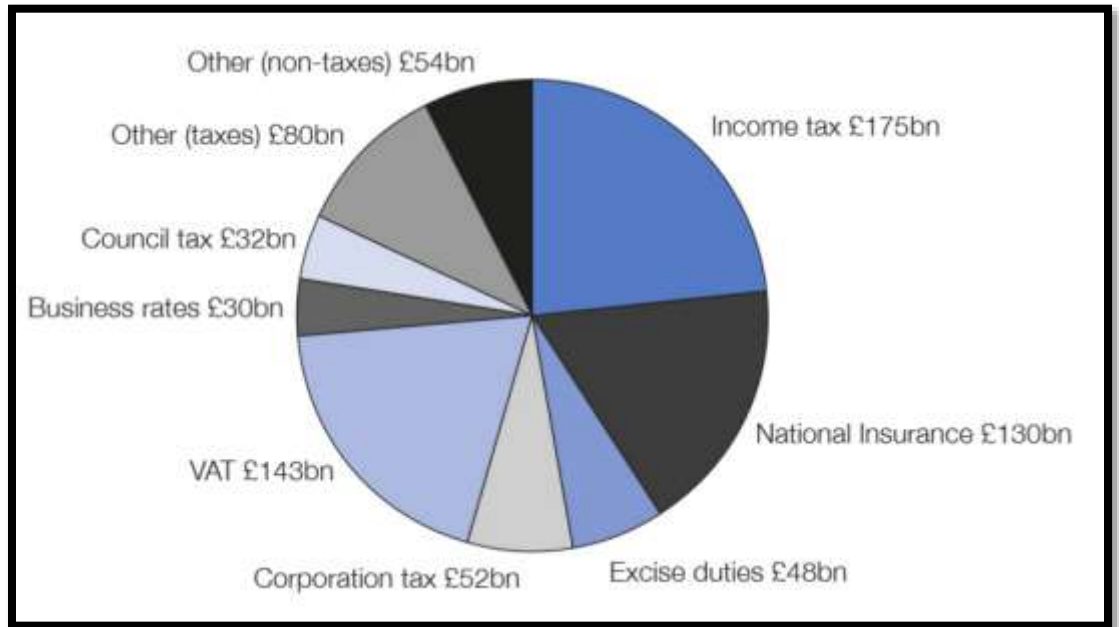
VAT is charged on things like:

- business sales - for example when you sell goods and services
- hiring or loaning goods to someone
- selling business assets
- commission



UK taxation for small businesses

- UK taxes for sole traders:
 - Income tax: taken off an employee's or business owners' salary. This results in less money to spend in the shops
 - VAT (only if they earn above £82,000) added to goods and services. A rise in VAT increases prices.
 - Business rates (but not if the work from home)
 - National insurance: contributions are payments made by both the employee and the employer. They pay for the cost of a state pension and the National Health Service. An increase in this tax raises a company's costs and could result in inflation.



UK taxation for larger businesses

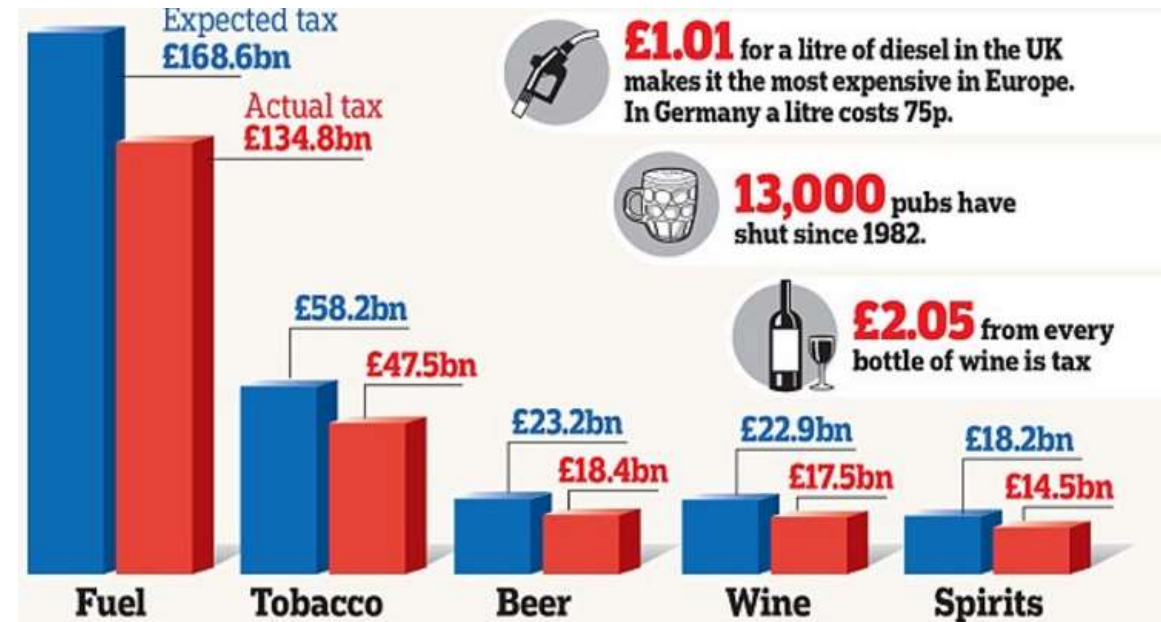
- UK taxes for ltd and plc businesses
 - Corporation tax at 20%
 - VAT at 20%
 - Business rates on business premises
 - National Insurance contributions to employees
- These are all costs to a business (Net profit)



UK taxation- excise duties

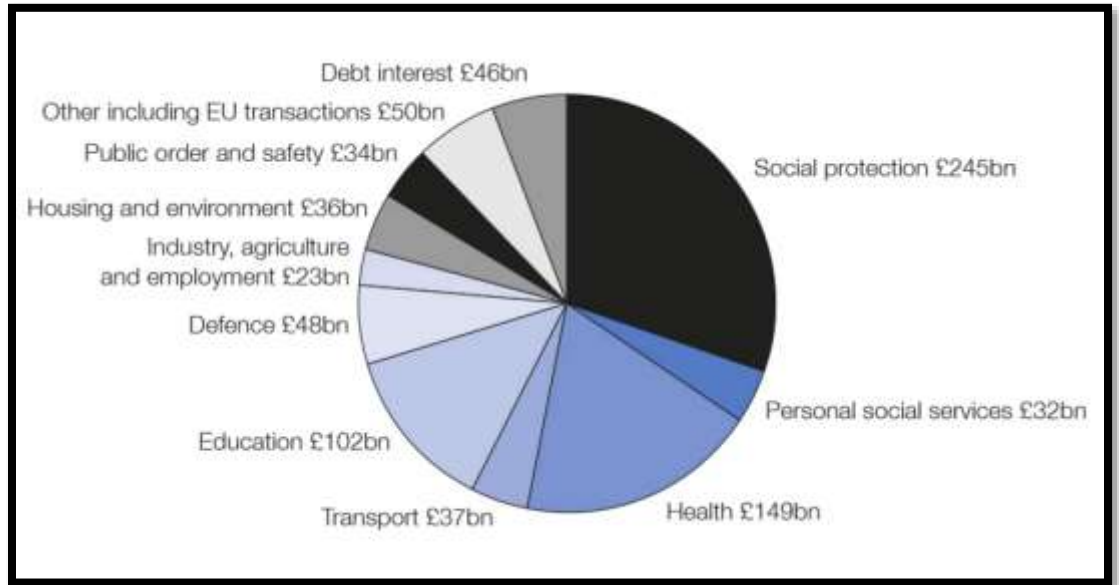


- Excise duty has to be paid by customers on products which are considered to have negative effects on society, in essence a sin tax e.g. fuel, tobacco, beer, wine and spirits
- If a UK business produces these goods they may see a reduction in demand



What is government spending?

- Taxes that the government collects goes into a central pot – this is then spent on various things for the benefit of the UK society
- The person who makes the decisions about tax and how to spend it is the Chancellor of the Exchequer also known as the treasurer
- The budget, taxation and public spending is extremely complex but you only need to know how changes might affect UK business



How is business affected by changes in government spending?

- If the government decides to cut government spending to reduce the deficit (amount it owes) this can have an impact on businesses which supply goods or services to public organisations e.g. the NHS
- Businesses affected for example in spending cuts may be care home providers, school builders

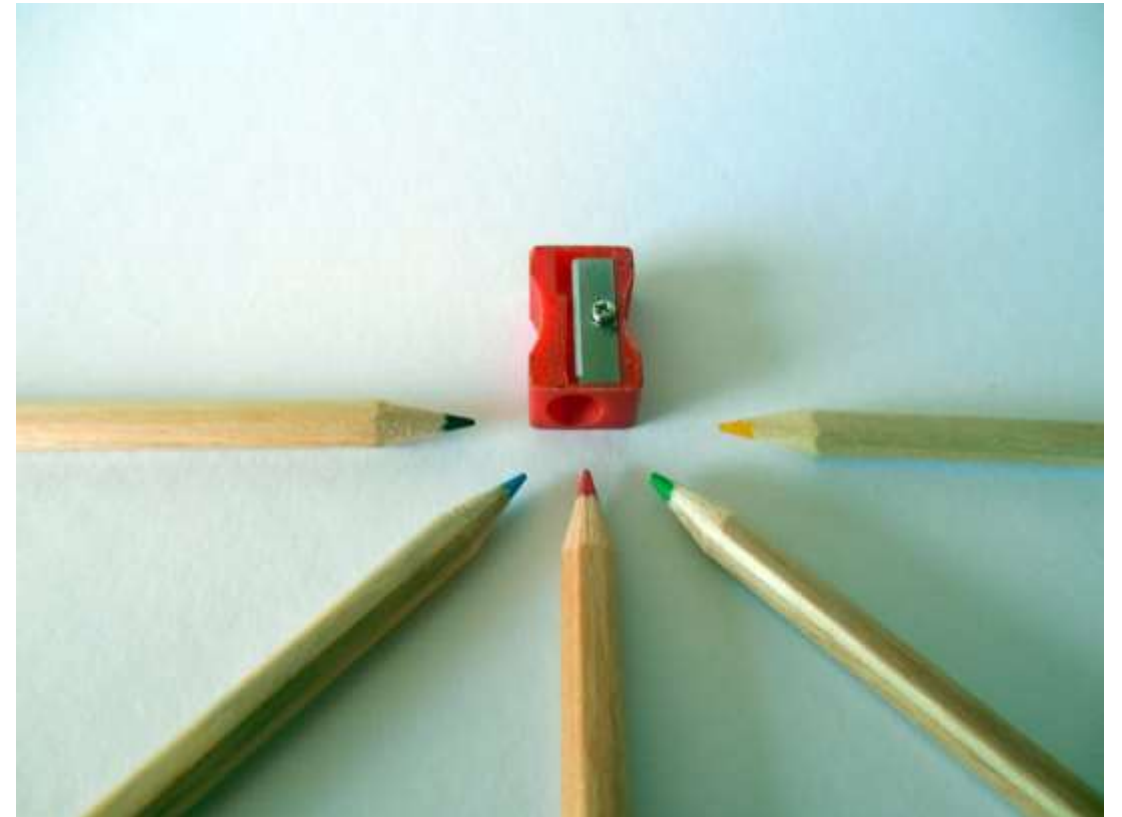
Construction industry expects government cuts to bite hard

Morgan Sindall believes government will reveal cuts of 35-40% in construction spending in October

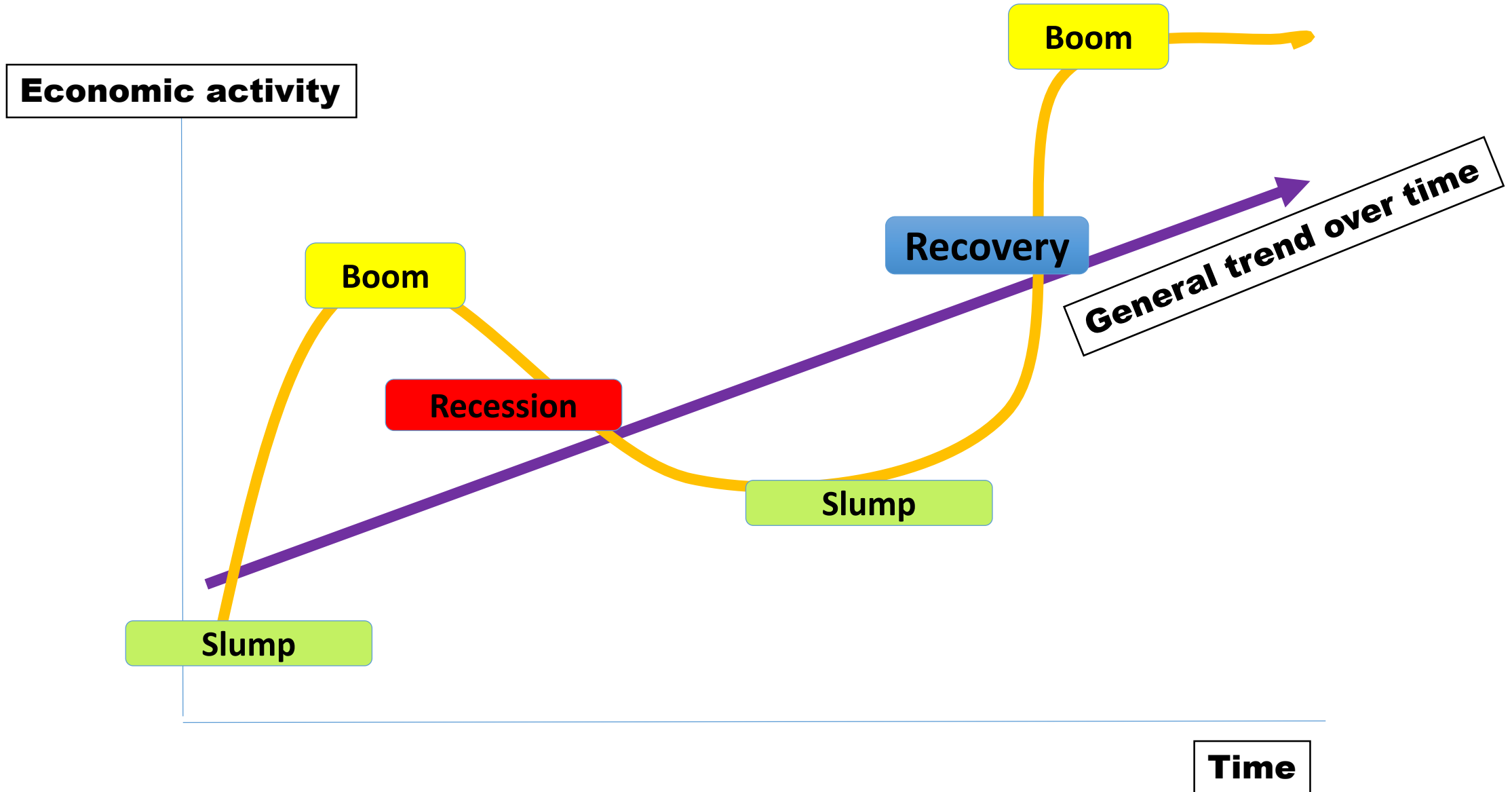


① Morgan Sindall has won a £1.1m contract to carry out preparatory work for the Crossrail project. Photograph: David Levene for the Guardian

You will need a ruler and selection of colours

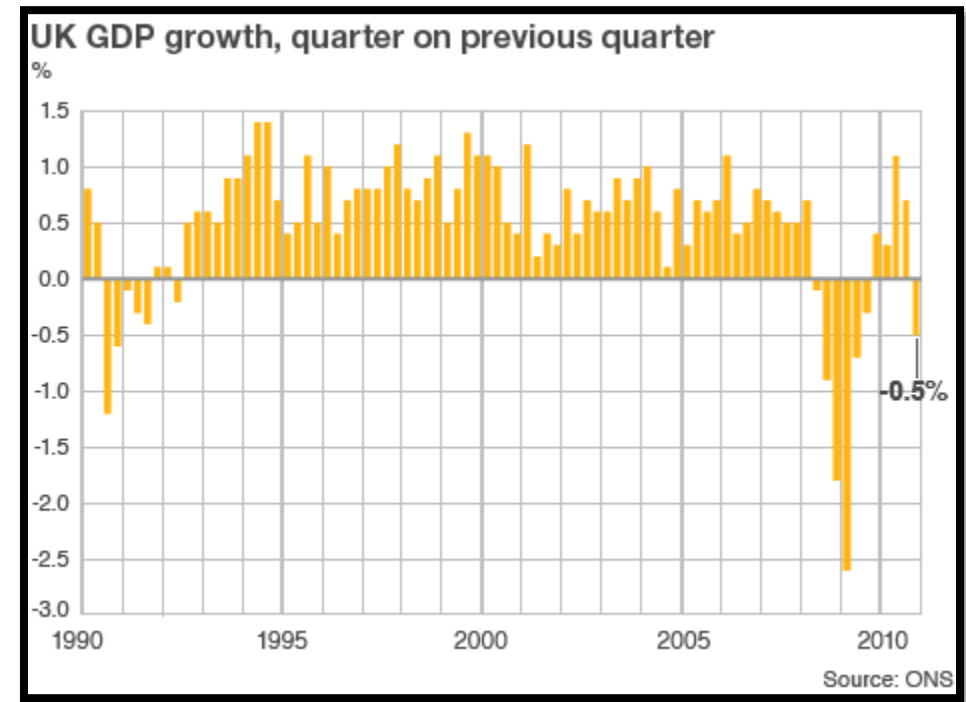


Draw a diagram – The Economic Cycle



The business cycle

- As time has passed over the last 150 years economist have noticed that demand and output in the UK changes, it goes up and down in a cycle pattern
- This is called the business cycle. Some text books call it the trade cycle and others call it the boom bust cycle.



Boom

- In boom times the UK enjoys a period of high consumer spending
- As consumers are spending there is an increased demand for goods and services
- This increase in demand means an increase in work, lower unemployment and higher wages
- This leads to more people in work able to buy more goods and services



Recession

- In times of recession the UK experiences falling levels of demand
- This means that consumers will demand less goods and services as they seek to save their money rather than spend – they worry about borrowing in case the interest rates go up
- Businesses will typically have to make redundancies to lower costs and will have lower profits as demand falls



Slump

- A slump is the bottom of the economic cycle where consumer confidence and spending is at its lowest
- There is usually very little investment in businesses and high levels of unemployment as demand for goods and services falls to nits lowest level



Recovery

- In the recover phase of the cycle demand levels for goods and services start to improve
- Unemployment will start to fall as businesses start to take on workers to meet new improving levels of demand
- Consumer confidence starts to return and consumers start to buy larger items again





The effect of economic uncertainty on the business environment

Economic uncertainty

- A series of financial shocks since the recession in the UK in 2008 has meant that there has been macroeconomic uncertainty
- This means that with a risk of unemployment that consumers are delaying the purchase of goods
- This means that demand falls for goods and services
- As a result of uncertainty manufacturers are reluctant to expand and to grow which affects and reduces supply of goods and services



Revision Video 1

An Economy



The more consumers spend the larger businesses tend to become.

This **increases output** in an economy, creating more **jobs** and **investment**. Thus the economy is **growing** in size.

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Revision video 2



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Revision video 3



Experts discuss the impact of an economic downturn and explain how to survive hard times.

Sample Edexcel A2 questions



Case study for question 1

Extract E

Young's Seafood Limited

Young's Seafood Limited is the leading UK fish and seafood processor, providing frozen and chilled, branded and retailer branded fish. Its teams create over 2 000 different products including smoked salmon, breaded scampi, fish pies, battered fish and fillets. Fish can play an important part in a healthy diet and official health guidance suggests that people should try to eat fish at least twice a week.

5

The following table shows the turnover and profit for Young's Seafood Limited in 2011 and 2012.

	January to December 2011	January to September 2012
Turnover	£458m	£425m
Operating profit	£9m	£7m
Operating profit margin	1.97%	1.64%

(Source: adapted from [www.youngseafood.co.uk/about us](http://www.youngseafood.co.uk/about-us))

Sample question 1

Explain how inflation could have impacted on the profitability of Young's Seafood Limited.

(4)

Knowledge
1

Application
2

Analysis
1

Answer sample question 1

Knowledge: 1 mark for showing an understanding of inflation, e.g. a sustained rise in the general price level in an economy.

Application: up to 2 marks for contextualised answers, e.g.

- fuel costs for running fishing boats may rise
- other costs of such as staff wages will rise, leading to an increase in Young's Seafood Limited's expenses

Analysis: 1 mark for developing a reason/cause/consequence of inflation on profitability, e.g.

- leading to a reduction in profit margins and therefore profitability.

Case study for question 2

Extract E

Tech sector “star performer” in UK economy

The UK's technology sector enjoyed “robust growth” in the final quarter of 2014. It had the widest performance gap between the technology industry and the rest of the UK economy for almost six years; according to KPMG's *Tech Monitor UK* survey. Interest rates at a historically low figure of 0.5% have contributed to the growth of the technology sector along with the launch of new products such as cloud-based initiatives, more emphasis placed on marketing and strong demand for technology-enabled services.

(Source adapted from: <http://startups.co.uk/tech-sector-star-performer-in-uk-economy>)

Sample question 2

Using Extract E, assess whether or not interest rates of 0.5% might have contributed to the 'robust growth' of the UK's technology sector.

(12)

Knowledge
2

Application
2

Analysis
4

Evaluation
4

Answer sample question 2

- Interest rates are the price of borrowed money. High interest rates may therefore deter businesses from borrowing as this could increase risk/reduce profits.
- 'Historically low' interest rates of 0.5% mean that firms may be encouraged to borrow due to the low cost of repayments. This could increase demand from customers who may purchase technology products, financed by taking out loans
- Technology firms could borrow money to invest in employing more staff, training in new software, expanding into bigger facilities, marketing and purchasing expensive, new equipment. This could lead to improved quality and productivity
- Investment in this industry is important due to its fast changing nature. Therefore, companies in this industry may need access to finance in order to be innovative.

Potential counterbalance:

- Growth in this industry has also been due to new products ('cloud based initiatives'), marketing and a strong and growing demand for technology enabled services. All of these factors indicate that the technology industry is successful because it is providing the products that consumers want
- Successful businesses in the technology sector may not need to borrow as they can finance investment through retained profits. This is a better source of finance as it is cheaper and less risky than borrowing
- Even with low interest rates, banks may be reluctant to lend, especially to start up businesses in the technology sector

Potential judgement

- Low interest rates will benefit technology companies who prefer to finance their investment and expansion plans through borrowing rather than selling shares
- Low interest rates would only have assisted growth through lower borrowing costs, arguably the most important reason has been due to new products and demand for more technology based services.

How to level sample question 2

Level	Mark	Descriptor
	0	A completely inaccurate response.
Level 1	1–2	Isolated elements of knowledge and understanding – recall based. Weak or no relevant application to business examples. Generic assertions may be presented.
Level 2	3–4	Elements of knowledge and understanding, which are applied to the business example. Chains of reasoning are presented, but may be assertions or incomplete. A generic or superficial assessment is presented.
Level 3	5–8	Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour/context. Analytical perspectives are presented, with developed chains of reasoning, showing cause(s) and/or effect(s). An attempt at an assessment is presented, using quantitative and/or qualitative information, though unlikely to show the significance of competing arguments.
Level 4	9–12	Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour/context. A coherent and logical chain of reasoning, showing cause(s) and/or effect(s). Assessment is balanced, wide ranging and well contextualised, using quantitative and/or qualitative information, and shows an awareness of competing arguments/factors leading to a supported judgement

Glossary

- **Interest rates;** cost of borrowing, the price of money
- **Inflation rates;** rise in cost of goods and services to buy (persistent increase in costs)
- **Unemployment rates;** rise in numbers not in employment
- **Tax;** monies demanded from the government so they have money to spend elsewhere like the NHS and on roads and education
- **Exchange rate;** the rate at which one currency can buy another £1 = \$1.67
- **Boom;** period when an economy is growing strongly
- **Recession;** A period when growth or output become negative (for two successive quarters 6 months)
- **Recovery;** When demand for goods and services starts to improve
- **Slump;** A period where there is a particularly deep and long fall in output



Revisionstation