

Cambridge IGCSE · Business Studies 0450 · Notes

Business activity

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What you need to know

By the end of this topic you should be able to:

1. **Explain needs, wants, scarcity and opportunity cost.** Needs are what people must have to survive; wants are what they would like to have. Resources are too few to satisfy every want (scarcity), so people, businesses and governments must choose, and every choice gives up the next best alternative (opportunity cost).
2. **Explain why specialisation matters.** Say what specialisation is, and give its benefits and drawbacks for a business and its workers.
3. **Explain the purpose of business activity:** combining resources to make goods and services that satisfy people's needs and wants.
4. **Explain added value and how a business can increase it.** Know that added value is the selling price minus the cost of bought-in materials, and the ways a business can widen that gap.

This topic is the same on Paper 1 and Paper 2. How businesses are classified (primary, secondary, tertiary sectors) and how they grow are separate topics.

Understand it

Needs and wants

A **need** is a good or service people must have to survive: food, water, shelter and clothing. A **want** is a good or service people would like to have but can live without: a phone, a holiday, a meal at a restaurant. Needs are limited; wants are **unlimited**, because as soon as one want is satisfied people find another.

Scarcity

The resources used to make goods and services (the **factors of production**) are limited:

- **land:** natural resources such as fields, water, minerals and timber;
- **labour:** people's time and skills;
- **capital:** machines, tools, buildings and vehicles made to produce other things;
- **enterprise:** the risk-taking and organising that combine the other three into a business.

Scarcity is the lack of enough resources to make all the goods and services people want. It is the reason every person, business and government has to make **choices**.

Opportunity cost

Because of scarcity, choosing one thing means going without something else. **Opportunity cost** is the **next best alternative given up** when a choice is made.

A bakery has 20 000 dollars to spend. It ranks three options: a new oven, a delivery van, then an advertising campaign. It buys the oven. The opportunity cost is **the delivery van**: only the next best option counts, not the van and the advertising together, and not the 20 000 dollars (that is the price, not what is given up).

Opportunity cost affects everyone's decisions:

- **Consumers** with limited income: buying a games console means not buying the bike they wanted next.
- **Workers** with limited time: working overtime gives up leisure.
- **Businesses** with limited finance: money spent on new machinery cannot also pay for more workers or advertising.
- **Governments** with limited tax revenue: a new road may mean one fewer hospital.

A good decision compares the benefit of a choice with what it gives up.

Specialisation

Specialisation is when people, businesses or countries **concentrate on what they are best at**. In a business, work is split into separate tasks (the **division of labour**) and each worker does the task they are most skilled at, so they become an expert in it.

Say a furniture workshop has 4 workers. When each makes whole chairs alone, together they make 8 chairs a day, so output per worker is 2. When one cuts wood, one shapes legs, one assembles and one finishes, each gets quicker at one job, and they make 12 chairs a day: output per worker is 3, a rise of 50%.

Benefits (to the business):

- **Higher output and efficiency**: workers are quicker at a task they repeat, and don't lose time moving between tasks.
- **Workers become expert**, so they make **fewer mistakes**, quality improves and less material is wasted.
- **Training is quicker and cheaper**, because each worker learns only one task.
- **Machinery is easier to use**, because a simple repeated task can be given to a machine.
- Together these lead to **lower cost per unit**, so the business can charge lower prices or earn a bigger profit margin.

Drawbacks:

- **Boredom and low motivation**: repeating one task all day can make work dull, so workers may slow down, make more errors or leave (higher labour turnover).

- **No cover for absent workers:** if the only person who does one task is off sick, production of that stage slows or stops.
- **Workers lose other skills** and may find it hard to get another job; a business that specialises in one product **does not spread its risk**.

Specialisation lets people swap: a baker bakes, a plumber fixes pipes, and each buys what the other makes with money. This is why businesses exist.

The purpose of business activity

A **business** combines land, labour, capital and enterprise to make **goods** (physical products, such as bread) and **services** (things done for people, such as a haircut) that satisfy customers' needs and wants. In doing so it:

- makes products people need and want, and supplies them where and when people want them;
- **employs** people, who earn incomes to buy other products;
- aims to **add value** to what it buys in, which is where the money for wages, rent, other costs and profit comes from.

Added value

A café buys coffee beans, milk and a paper cup for 1.50 dollars and sells the cup of coffee for 4.00 dollars. The customer pays more than the materials cost because the café has turned them into something more useful: a hot drink, made by a skilled barista, ready to drink, in a pleasant place.

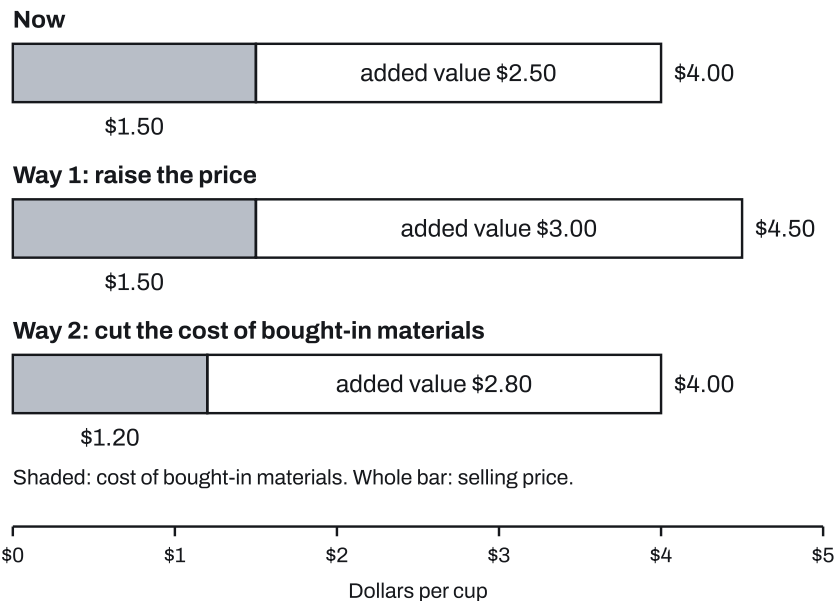
$$\text{added value} = \text{selling price} - \text{cost of bought-in materials}$$

So each cup has an added value of $4.00 - 1.50 = 2.50$ dollars. On 300 cups a day, the café adds $300 \times 2.50 = 750$ dollars of value.

Added value is **not profit**. Out of the 2.50 dollars the café still has to pay wages, rent and electricity; what is left is profit. Only the **bought-in materials** (the inputs bought from other businesses and used up in the product) are taken away to find added value.

How to increase added value

Added value is the **gap between price and the cost of bought-in materials**, so there are only two ways to widen it:



Way 1: charge a higher price (costs stay the same). Customers only pay more if they think the product is worth more, so the business must first make it more desirable:

- **better quality** of the product or its materials;
- **branding, advertising or attractive packaging**, so it seems worth more;
- **excellent customer service**;
- **unique features or design** that competitors don't offer;
- **convenience**: a product that is ready to use, or available right now, near the customer.

Way 2: cut the cost of bought-in materials (price stays the same):

- **buy cheaper materials** or change to a **cheaper supplier**;
- **negotiate a lower price** or buy in bulk to get a discount;
- **use fewer materials** in each product (for example, redesign it to use less fabric) or waste less.

Each way has a **risk**:

Way	How it raises added value	Risk
Raise the price	The price rises, costs don't, so the gap widens	Customers may buy less or switch to cheaper competitors, so total sales and revenue can fall; the improvement (quality, branding) itself costs money
Cut material costs	Costs fall, the price doesn't, so the gap widens	Cheaper materials can lower quality, bringing complaints, a worse reputation and lost sales

Which is better depends on the business. One known for **high quality** (or with loyal customers and few competitors) can usually raise its price safely, while cheaper materials would put its reputation at risk. One in a **price-competitive market** with many rivals may do better by cutting material costs, as long as the quality

customers notice doesn't fall.

Key facts and formulas

This topic has no formula list in the exam. "Learn it" means you must remember it.

Formula or fact	Status
Added value = selling price – cost of bought-in materials	Learn it
Added value rises if the price rises (costs the same) or material costs fall (price the same)	Learn it
Need: essential for survival (food, water, shelter, clothing); want: desired but not essential	Learn it
Scarcity: not enough resources to satisfy all wants, so choices must be made	Learn it
Opportunity cost: the next best alternative given up when making a choice	Learn it
Specialisation: people or businesses concentrate on what they are best at	Learn it
Factors of production: land, labour, capital, enterprise	Learn it

How to do it

We have tagged 15 questions on this topic (2021–2025), one part on it in each, so 15 parts. Business activity is always one part of a longer 20-mark question.

Question type	Questions
Explain ways a named business can increase added value	5
Evaluate ways to increase added value and choose the best	4
Benefits and drawbacks of specialisation	4
Define a key term	2

The mark scheme codes are **k** (knowledge: a correct point), **app** (application: a reference that fits the business in the question), **an** (analysis: a developed consequence) and **eval** (evaluation: a justified judgement).

1. Explain ways a named business can increase added value (5 questions)

The question names a business: "Explain two ways Brendan could increase added value for his business" (**0450/11/M/J/25 Q1**), "Outline two ways EQR could increase added value", or "Explain how each of the following can help Jerome increase added value", followed by two given ways.

For each way:

1. **Name the way** (k): higher price through better quality, branding or packaging, service, unique design or convenience; or lower material costs through a cheaper supplier, cheaper or fewer materials.

2. **Apply it (app)**: use a detail from the case, such as the product (flowers, drinks, T-shirts), the number of shops or a figure. Use a **different** detail for each way.
3. **Explain how it raises added value (an)**: say that it **widens the gap between the price and the cost of bought-in materials**, and why (customers are willing to pay more because..., or each item costs less to make because...).

Variations you will meet:

- **"Outline two ways" (4 marks, Paper 1)**: k + app for each way. No analysis needed, but the way must be a real way to raise added value.
- **"Explain two ways" (6 marks, Paper 1)**: k + app + an for each way.
- **One or two given ways** ("change the packaging", "use cheaper materials", "providing a good quality service"): explain **how** that way raises added value, not whether it is a good idea. Packaging raises added value because it makes the product **seem worth more, so a higher price can be charged** (not because it "attracts more customers", which examiners don't credit).
- **"Explain two ways" (8 marks, Paper 2)**: 1 mark for each way and up to 3 more for its explanation, at least one of them about the case. Build a three-step chain: the way (1) → how the business would do it, in context (1) → why customers pay more or inputs cost less (1) → so the gap between price and input costs widens (1).

2. Evaluate ways to increase added value and choose the best (4 questions)

Paper 1 part (e), 6 marks: "Explain two ways a business can increase added value. Which is likely to be the best way? Justify your answer." It is a **general** question, so no application marks.

1. **Way 1 (k)**, with how it widens the gap (an).
2. **Way 2 (k)**, with how it widens the gap (an).
3. **Decision (eval ×2)**: choose one and say **why it is better than the other**. The second eval mark needs a comparison: "...whereas cheaper materials could lower quality and damage the reputation, losing sales."

Paper 2 part (b), 12 marks, levels: "Consider two ways (for example increasing prices and reducing raw material costs). Which should the business use? Justify your answer."

1. **For each way**: how the business would do it, using the case (its product, reputation, competitors, customers), how it increases added value, and its **risk**, all as linked chains.
2. **Recommendation**: choose one, justify it with the case, and say **why you rejected the other**. That last part is what lifts an answer to the top of Level 3 (9–12).

Good judgements come from the case: a business known for high quality should raise prices rather than risk its reputation with cheaper inputs; a business facing strong price competition, or whose customers would not notice a change in materials, might cut costs instead.

3. Benefits and drawbacks of specialisation (4 questions)

1. **Name the benefit or drawback (k)**: from the lists in "Understand it".

2. **Develop it** (an): say what it leads to, for example "workers become expert in one task, **so** they make fewer mistakes, **so** less material is wasted".
3. **Apply it** (app) when the question names a business: its product, its number of employees, its factory.

Variations you will meet:

- **"Identify two benefits of specialisation" (2 marks)**: two short points, no explanation. Only the first two count.
- **"Explain one advantage and one disadvantage to DJU of using specialisation" (6 marks, Paper 1)**: k + app + an for each.
- **"Explain two advantages" or "two benefits and two drawbacks" (8 marks, Paper 2)**: for two advantages, 1 each plus up to 3 marks of explanation (one in context); for two benefits and two drawbacks, 1 each plus 1 for each explanation. Don't drift into flow production or delegation: the point must be about workers concentrating on one task.

4. Define a key term (2 questions)

2 marks for a full definition, 1 for a partial one. An example alone earns nothing.

- **Specialisation**: people or businesses **concentrating on what they are best at** (2). Partial: "workers do only one job" (1). Adding "so they become expert at it" completes it.
- **Opportunity cost**: the **next best alternative given up** when making a choice (2). Partial: "what you give up" (1).
- Learn **need**, **want**, **scarcity** and **added value** the same way, even though they haven't been asked as definitions in 2021–2025.

Worked examples

Example 1

Define "added value". [2]

Added value is the difference between the selling price of a product (1) and the cost of the bought-in materials used to make it (1).

Example 2

KRT is a bakery with 12 employees. It sells loaves of bread for 3.00 dollars each; the flour, yeast and packaging for each loaf cost 1.10 dollars. KRT sells 500 loaves a day.

(a) Calculate the added value on one day's sales. [2]

(b) Explain two ways KRT could increase added value. [6]

(a) Added value per loaf = $3.00 - 1.10 = 1.90$ dollars (1). For 500 loaves: $500 \times 1.90 = 950$ dollars a day (1).

(b) **Way 1.** KRT could improve the quality of its bread (k), for example using wholegrain recipes baked fresh each morning for its loaves (app). Customers would see the bread as worth more and pay a higher price, which widens the gap between the price and the 1.10 dollars of materials in each loaf (an).

Way 2. KRT could buy its flour in bulk from a cheaper supplier (k), lowering the 1.10 dollar cost of bought-in materials (app). If it still charges 3.00 dollars, each loaf earns more above the cost of its inputs, so added value rises (an).

Example 3

FRK is a restaurant with a kitchen of 8 chefs. Until now every chef cooked whole meals. The head chef now wants each chef to work at one station only: starters, grill, sauces or desserts.

Explain two advantages to FRK of its chefs specialising in this way. [8]

Advantage 1: meals are cooked faster. A chef who works only on the grill repeats the same few dishes all evening (1), so they get quicker at them and don't lose time moving between stations (1). The kitchen can serve more tables on a busy evening without hiring a ninth chef (app) (1), so FRK's revenue rises while its wage costs stay the same (1).

Advantage 2: fewer mistakes and less waste. Each chef becomes an expert at one type of dish (1). A dessert chef who makes the same puddings every night gets the quantities right more often (1), so fewer plates are sent back and less food is thrown away (app) (1), cutting FRK's food costs per meal (1).

Each advantage earns 1 mark, plus up to 3 for its explanation, one of them in the context of FRK.

Example 4

LTB sells handmade leather bags online for 120 dollars each; the leather, lining and buckles for each bag cost 45 dollars. The owner is choosing between two ways to increase added value:

- offer free personalised engraving of the customer's initials on each bag;
- buy leather from a cheaper supplier at 36 dollars a bag.

Which way should LTB choose? Justify your answer. [6]

Free engraving makes each bag unique to its buyer (k). Many handmade bags are bought as gifts, so customers would accept a higher price than 120 dollars for a personal touch, widening the gap over the 45 dollars of materials (an).

Cheaper leather cuts the cost of bought-in materials from 45 to 36 dollars a bag (k), so at the same price added value rises from 75 to 84 dollars a bag (an).

LTB should offer engraving. It sells only online, where buyers cannot touch the leather and rely on reviews, so any fall in leather quality would soon show up in poor reviews and cut future sales (eval). Engraving uses the owner's time rather than extra bought-in materials, so it does not reduce added value, although LTB should first test whether customers will really pay more for it (eval).

Common mistakes

- **Explaining how to increase sales or profit, not added value.** Examiners report many answers about attracting more customers. Added value is about the **price of each item compared with its material costs**: say how the way lets a higher price be charged or cuts the cost of inputs.
- **Stopping at the way.** Naming "branding" or "better packaging" earns only the knowledge mark. Strong answers finish the chain: "so customers believe it is worth more, so they will pay a higher price, which widens the gap between price and input costs."
- **Taking away the wrong costs.** Added value subtracts only the cost of **bought-in materials**, not wages, rent or all production costs.
- **Discussing whether a way is a good idea when asked how it works.** "Explain how X can increase added value" wants the mechanism, not its advantages and disadvantages.
- **Repeating the same application.** Using "flowers" for both ways earns one app mark. Use a different case detail for each point.
- **Confusing specialisation with other topics.** Points about flow production or delegation don't answer a specialisation question; and "workers do one job" is only a partial definition: add that they concentrate on what they are **best at**.
- **Listing without developing.** "Boredom, absence, training" earns knowledge only. Each point needs a "so..." consequence.
- **A recommendation with no comparison.** "Raising prices is best" alone earns little. Say why it is better **than the other way**, using the case.

How to get the marks

- **Command words.** *Define*: the exact meaning. *Identify*: name the point, no explanation (only the first answers given count). *Outline*: a point with a brief reference to the case. *Explain*: a point, applied, developed with "so" or "because". *Consider ... which should ... Justify*: both options, then a decision.
- **Application.** When the question names the business, each point needs a detail from the stem that makes sense for it (its product, number of employees, a figure). "General" questions (Paper 1 part (e)) give no marks for application, so don't waste time on it there.
- **Analysis** is the consequence: how the way widens the price–cost gap, or what a benefit of specialisation leads to (more output, lower unit cost, fewer complaints).
- **Evaluation** needs both sides first, then a decision that says **why one beats the other**, often with "it depends on..." (the business's reputation, its competitors, whether customers will notice).

- **Paper 2 level marking.** Level 3 (9–12) needs both options discussed in detail, in context, and a recommendation that also says why the alternative was rejected. Examiners say conclusions should use the case, not repeat the earlier points.
- **Calculations.** Show the working (" $3.00 - 1.10$ ") and give units; the method alone earns a mark if the answer is wrong.

Quick check

1. A shop buys a phone case for 4 dollars and sells it for 11 dollars. Find the added value per case, and the added value if it sells 250 cases.
2. The shop finds a supplier selling the case for 3.20 dollars and raises its price to 12 dollars. Find the new added value per case and the percentage increase in added value per case.
3. A student has an evening free. She ranks her options: revise for a test, go to the cinema, then watch television. She revises. What is the opportunity cost?
4. Identify two drawbacks of specialisation for a business. **[2]**
5. Outline how offering excellent customer service could help a hairdresser increase added value. **[2]**

Answers

1. $11 - 4 = 7$ dollars per case; $250 \times 7 = 1750$ dollars.
2. $12 - 3.20 = 8.80$ dollars per case. Percentage increase = $\frac{8.80 - 7}{7} \times 100 = 25.7\%$ (3 s.f.).
3. The trip to the cinema: the next best alternative she gave up (not the television as well).
4. Any two: workers get bored and less motivated (1); production stops when a specialist worker is absent (1); workers lose other skills; the business does not spread its risk.
5. Excellent service makes customers feel the haircut is worth more, so they are willing to pay a higher price (1); the price rises while the cost of bought-in materials such as shampoo stays the same, so the gap between them, the added value, widens (1).

Past questions to try

- 0450/13/M/J/24 Q1: part (e), two ways to increase added value and the best one.
- 0450/11/O/N/21 Q1: part (d), how new packaging and cheaper materials raise added value.
- 0450/21/O/N/21 Q1: part (a), two benefits and two drawbacks of specialisation.
- 0450/12/M/J/22 Q4: part (b), defining opportunity cost.