Edexcel (B) Economics A-level

Theme 3: The Global Economy

3.2 Economic Factors in Business Expansion

3.2.2 Assessing the potential of different economies

Notes

Factors influencing expansion into a market:

Ease of doing business

This is influenced by government policy, corruption, political stability, conflicts and the stability of the economy. The easier it is to do business in a market, the more likely it is that a firm will expand into the market. This will help keep costs of production lower and encourage firms to increase production.

Government policy could make doing business difficult and restricted. Excessive red tape can increase a firm's production costs, since it makes doing business complicated.

Exchange rate

A depreciation in the pound means that UK exports become more price competitive. Firms could then reduce the price of the good in the export market to increase sales, or they can keep the price the same to increase their profit margins.

However, if UK goods are relatively price inelastic, a depreciation in the pound will not increase sales in the export market significantly. Moreover, it depends on the rate of economic growth in the export market. The higher the level of consumer and firm confidence, and the more disposable income they have, the more likely they are to purchase UK exports.

If firms are net importers of raw materials, costs of production will increase because imports are relatively more expensive when the pound is weaker. This could make the firm less internationally competitive, and it could mean they make lower profits. However, if firms have fixed contracts for how long they import materials from another country, then changes in the exchange rate will not affect quantity purchased or the price paid. This reduces uncertainty of production costs for firms.

If the pound depreciates, firms might think that they can increase their profit margins by keeping the price the same, without having to increase efficiency or productivity to lower their average costs.

Factors influencing the location of production sites:

- ### Costs of production

The lower the costs of production, especially if labour costs are lower, the more attractive the location is for production. This is particularly the case for manufactured goods, where labour costs make up a large proportion of production.

Recently, due to higher average incomes in China, production has moved out of the country, since it has become more expensive. Countries such as Mexico have become more attractive. Even though labour costs are slightly higher in Mexico, transport costs are lower to America, so goods can be produced more cheaply.

Costs of production are also influenced by the **skills and availability of the labour force.** If the labour force already possesses the relevant skills, then firms save money on training costs. It is also more convenient and cheaper for firms if the labour force is available, since this makes production easier.

- ### Government incentives

Governments could incentivise production by providing subsidies to firms. This encourages firms to produce in a particular country since production costs are lower.

- ### Natural resources

Countries with easy access to natural resources, such as oil, are more attractive to firms for production, since it keeps production costs low.

- ### Likely return on investment

Firms are more likely to be located in a site where their return on investment is high and predictable. This makes planning for the future predictable and it ensures their production is profitable.