CHAPTER

05

DEMONSTRATE AN UNDERSTANDING OF THE FUNCTION OF THE MARKET MECHANISMS IN A NEW VENTURE

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Chapter 5

Demonstrate an Understanding of the Function of the Market Mechanisms in a New Venture

Every entrepreneur operates within a broader economic system that shapes — and is shaped by — every business decision made. Understanding how markets work, how prices are determined, how economic forces influence business performance, and how South Africa fits into the global economy is not academic theory: it is practical intelligence that helps entrepreneurs make smarter pricing decisions, identify better opportunities, manage risk more effectively, and build ventures that thrive across economic cycles. This chapter equips you with the economic literacy every serious entrepreneur needs.

By the end of this chapter, you will be able to:

❖ Define key economic terms: economic system, free market, business venture, and competition.

❖ Explain and compare the four main economic systems: market economy, socialism, command economy, and mixed economy.

❖ Describe the role and benefits of competition in a free market system, with South African examples.

❖ Explain imperfect competition and identify the four main market structures: monopoly, oligopoly, monopolistic competition, and oligopsony.

❖ Analyse the advantages and disadvantages of competition for both consumers and businesses.

❖ Describe how consumers, producers, and government interact in the economic system.

❖ Explain the conditions for perfect and imperfect markets, and apply the concepts to the South African context.

❖ Define and explain the Law of Demand and the Law of Supply, with real-world examples.

❖ Explain the concept of market equilibrium and how surpluses and shortages are corrected.

❖ Distinguish between movements along and shifts of supply and demand curves.

❖ Identify and explain the factors that cause demand curves and supply curves to shift.

❖ Explain the four factors of production — land, labour, capital, and entrepreneurship — and their roles in the economy.

❖ Explain the role of money at three levels of the economy: government, firms, and individuals.

❖ Evaluate the effects of cyclical economic movements on new ventures.

❖ Explain the concept of inflation, its causes, its effects, and its impact on business planning.

❖ Identify the reasons for currency value decline and explain exchange rate dynamics.

❖ Explain the role of GDP, interest rates, the Banker's Acceptance Rate, and the Balance of Payments in the economy.

❖ Describe international trade and its connection to uneven resource distribution.

❖ Identify the key socio-economic factors that underline the importance of entrepreneurship in South Africa.

❖ Identify and classify growth sectors in South Africa that offer new venture opportunities.

Section 1: The Free Market System

Every society must organise itself to answer three fundamental economic questions: What should be produced? How should it be produced? And for whom should it be produced? The mechanism by which a society answers these questions is its economic system. Understanding different economic systems — and where South Africa sits within that spectrum — gives the entrepreneur critical context for every strategic decision they make.

1.1 Key Definitions

Economic System: A country's plan for producing and distributing goods and services, and the institutional arrangements through which those decisions are made and implemented.

Free Market: A market economy based on supply and demand with little or no government control, in which prices are determined by the voluntary interaction of buyers and sellers.

Business Venture: A start-up entity developed with the intent of generating profit by meeting a market need. Ventures may be funded by the entrepreneur alone or in combination with investors.

Competition: The rivalry between two or more businesses seeking the same customers, market share, or resources. Competition is the engine that drives efficiency, innovation, and consumer value in a market economy.

Market Mechanism: The process by which supply and demand forces determine prices and quantities in a free market without central direction.

1.2 The Four Major Economic Systems

Economists identify four major types of economic systems in operation in the world today. In practice, most economies are hybrids — they blend elements of multiple systems. Understanding each in its pure form provides the analytical foundation for understanding how South Africa's mixed economy actually operates.

Market Economy (Capitalism)

In a pure market economy, resources are owned by private individuals and businesses, economic decisions are made by millions of independent actors responding to price signals, and government intervention is minimal. The profit motive drives production — goods and services are produced because someone believes they can be sold at a profit.

Key characteristics: private ownership of resources and means of production; freedom to buy and sell goods freely; prices set by supply and demand; competition among businesses; consumer sovereignty (consumers 'vote' with their purchasing decisions); and profit as the primary incentive for economic activity.

Advantages: high economic efficiency; rapid innovation driven by competitive pressure; wide variety of goods and services; freedom of choice for both producers and consumers. Disadvantages: potential for inequality; underproduction of public goods; market failures (externalities, monopolies); economic instability (boom and bust cycles).

Socialist Economy

In a socialist economy, the state owns many (but not all) productive resources and makes decisions about what to produce and how to distribute it. Socialist economies prioritise collective welfare over individual profit. Many countries incorporate socialist elements without being fully socialist — universal healthcare, public education, and social grants are examples of socialist policies within broadly market-oriented economies.

Key characteristics: government ownership of key industries and infrastructure; social planning of production and distribution priorities; universal provision of core services (health, education, housing); redistribution of wealth through taxation and social programmes.

South African context: South Africa incorporates significant socialist elements including public healthcare, subsidised education, social grants for over 18 million recipients, and state-owned enterprises in energy, transport, and telecommunications.

Command Economy

In a command economy, the government owns virtually all productive resources and makes all economic decisions centrally. There is no market mechanism for price determination — the state sets prices, production targets, and distribution of goods. Pure command economies have largely failed in practice because central planners cannot process the enormous complexity of information that millions of market participants handle effortlessly through price signals.

Key characteristics: state ownership of all (or virtually all) means of production; central planning of all production and distribution decisions; prices set by government decree; no competition; limited consumer choice; government-assigned employment.

Historical examples include the Soviet Union (1917-1991) and present-day North Korea and Cuba. Shortages are endemic in command economies because prices cannot signal the relative scarcity of goods to producers.

Mixed Economy

A mixed economy combines private ownership and market mechanisms with government regulation and a degree of public ownership. In practice, virtually every modern economy is a mixed economy — the question is always one of degree, not of type.

Key characteristics: private sector and government both own productive resources; markets determine most prices but government regulates to correct market failures; government provides public goods and social safety nets; competition policy prevents monopoly abuse.

South Africa is a mixed economy: the private sector drives most production and employment, while the government owns key enterprises (Eskom, Transnet, South African Airways), regulates markets through competition law and sector-specific regulators, and provides social services and grants. The entrepreneur operates primarily in the private market sphere but must understand how government policy shapes the competitive environment.

Traditional Economy

Traditional economies are found in rural, non-industrialised communities where economic decisions are governed by custom, tradition, and social norms rather than market mechanisms or central planning. Production methods, trade patterns, and resource allocation follow patterns established over generations.

Key characteristics: subsistence production (producing for own consumption rather than for sale); barter rather than monetary exchange; economic roles defined by gender, age, and social position; limited use of technology; strong community ties and shared resources.

Traditional economy elements persist in parts of rural South Africa alongside the formal market economy — an entrepreneurial opportunity for those who understand both systems.

Comparing Economic Systems

Feature	Market	Socialist	Command	Mixed
Resource Ownership	Private	Mostly state	Entirely state	Both private and state
Price Determination	Market forces	Partly planned	Government set	Mostly market, some regulated
Incentive	Profit	Collective welfare	Central targets	Profit + social goals
Consumer Choice	Very high	Moderate	Very low	High
Inequality	High	Lower	Low (officially)	Moderate
Innovation	Very high	Moderate	Low	High
SA Relevance	Private sector	SOEs, grants	Limited	Primary system

1.3 Competition in the Free Market System

Competition is the animating force of the market economy. It is the mechanism that drives businesses to serve customers better, produce more efficiently, innovate continuously, and price competitively. Without competition, markets become stagnant and consumers are exploited. The South African Competition Commission exists precisely to maintain competitive markets and prevent anticompetitive behaviour.

The Four Benefits of Competition

Lower Prices for Consumers

Competition forces businesses to price competitively to attract customers. Each competitor knows that a customer who finds a better deal will switch — so the pressure to offer value is continuous. In South Africa's mobile telecommunications market, the arrival of new players like Cell C and later Telkom Mobile forced the established duopoly of Vodacom and MTN to reduce call rates dramatically over a decade. The consumer benefited enormously from this competitive pressure.

Efficiency and Productivity Improvement

Businesses facing vigorous competition cannot afford complacency. They are constantly pressured to find ways to reduce costs, improve processes, and deliver more value per rand spent. This pressure produces the efficiency gains that drive economic growth and rising living standards. Businesses that fail to keep pace lose market share to more efficient competitors — this is the market's ruthless but effective mechanism for resource allocation.

Innovation and New Product Development

In a competitive market, the entrepreneur who identifies a better way to serve a customer need — a better product, a more convenient delivery method, a faster service — wins market share. This constant search for competitive advantage drives innovation. The South African fintech sector is a current example: competition from startups like Yoco, PayFast, and Peach Payments has forced established banks to innovate their payment and banking platforms far more rapidly than they otherwise would have.

Structural Restructuring of the Economy

Competition reallocates resources from less productive to more productive uses. When an industry or firm loses competitiveness, capital, labour, and entrepreneurship move to sectors and firms where they create more value. This process is disruptive in the short term — businesses close, workers must retrain — but it is the mechanism by which economies continuously upgrade their productive capabilities.

Advantages and Disadvantages of Competition

Advantages	Disadvantages
✓ Lower prices and better value for consumers in competitive markets.	✗ Potential for wasteful duplication — multiple businesses building similar infrastructure.
✓ Higher quality products and services as businesses compete for customer preference.	✗ Advertising bombardment — competing businesses all spending on persuasion rather than production.
✓ Faster innovation as businesses race to offer better solutions.	✗ Short-termism — competitive pressure can discourage long-term investment that doesn't pay off quickly.
✓ Greater variety and choice — competition rewards differentiation.	✗ Potential for destructive competition — price wars that destroy profitability for all players.
✓ Efficiency gains that reduce production costs and benefit both producers and consumers.	✗ Risk of market consolidation — intense competition can drive out smaller players, leading to oligopoly.
✓ Prevention of monopoly exploitation — competition is the natural check on market power.	✗ Stress and instability for business owners who must continuously adapt to competitive threats.
✓ Opportunities for entrepreneurs to enter markets and succeed by out-serving incumbents.	

1.4 Imperfect Competition and Market Structures

Perfect competition — the theoretical ideal of many small producers selling identical products with perfect information and free entry — does not exist in the real world. All real markets are imperfect to some degree. Understanding the different market structures gives the entrepreneur insight into the competitive dynamics they will face and the strategic options available to them.

Perfect Competition

The theoretical benchmark against which real markets are measured. Characteristics: many small buyers and sellers; identical (homogeneous) products; perfect information; free entry and exit; all firms are price takers (no single firm can influence the market price).

Why it matters to entrepreneurs: perfect competition is the most competitive market structure. If your market is approaching perfect competition, you must either differentiate your product to escape commoditisation, find ways to reduce costs below competitors, or seek a less competitive niche. Agriculture and basic commodities come closest to perfect competition in practice.

Monopolistic Competition

The most common real-world market structure. Characterised by: many competitors; differentiated products (each slightly different from competitors'); relatively easy entry and exit; some degree of price-setting ability (based on differentiation).

South African examples: restaurants, hairdressers, clothing retailers, accounting firms, legal practices. Each has many competitors but differentiates through quality, location, specialisation, personality, or reputation. The entrepreneurial strategy in monopolistic competition is to find and communicate a genuine point of differentiation that makes your offering the obvious choice for a specific customer segment.

Oligopoly

A market dominated by a small number of large firms, each of which has significant market power and is acutely aware of its competitors' actions. Characteristics: few large firms; high barriers to entry; interdependence of decisions (each firm's pricing and marketing decisions affect all others); potential for collusion.

South African examples: commercial banking (the 'Big Four' — Standard Bank, ABSA, FNB, and Nedbank), mobile telecommunications (Vodacom, MTN, Cell C), liquid fuels (BP, Shell, Engen, Total), supermarkets (Shoprite, Pick n Pay, Woolworths, Spar).

Entrepreneurial implication: entering an oligopolistic market head-on is extremely difficult — the incumbents have massive resources and can sustain predatory pricing to drive out new entrants. The successful strategy is typically to find an underserved niche or geographic segment where the oligopolists' attention is focused elsewhere.

Monopoly

A market supplied by a single producer with no close substitutes, protected by significant barriers to entry. Characteristics: one seller; no substitutes; significant barriers to entry; the monopolist is the price maker (sets price rather than accepting market price).

Types of monopoly in South Africa: natural monopolies (Eskom's electricity generation and transmission network — the infrastructure cost makes multiple competing networks economically inefficient); state monopolies (PostBank, certain elements of Transnet's rail network); local monopolies (the only pharmacist in a rural town); and legal monopolies (intellectual property protection creates temporary monopoly on inventions and creative works).

Entrepreneurial implication: selling to a monopoly customer creates extreme buyer power — the monopolist can dictate terms. If your market is dominated by a monopoly supplier, your costs and supply reliability are at their mercy. Understand and manage your exposure to monopoly power on both the supply and demand sides of your business.

1.5 Roleplayers in the Economic System

The economy is not a machine — it is a system of interdependent human decisions. Three categories of actors make those decisions, and their interactions determine economic outcomes:

Consumers — The Demand Side

Consumers are the ultimate purpose of economic activity. Their decisions about what to buy, how much to spend, and what to save shape every other decision in the economy. Key consumer behaviours: purchase decisions based on price, quality, and preference; utility maximisation — allocating limited income to maximise personal well-being; rational decision-making (in theory) — evaluating alternatives and choosing the highest value option.

Consumer confidence is a critical economic barometer. When consumers feel financially secure, they spend more — stimulating business activity and employment. When they feel threatened (by unemployment, rising prices, or political instability), they reduce spending and increase saving — contracting economic activity. The entrepreneur must monitor consumer confidence indicators as leading signals of demand changes in their market.

Producers (Businesses) — The Supply Side

Businesses convert economic inputs (land, labour, capital, and entrepreneurship) into goods and services that consumers value. Their decisions about what to produce, how to produce it, and at what price to sell it are driven primarily by profit — the reward for organising production successfully and bearing the associated risk.

Businesses also employ workers, invest in capital, pay taxes, innovate, and contribute to the social fabric of the communities in which they operate. The quality of business decision-making — at the aggregate level — determines how productively a society uses its resources and therefore how wealthy it becomes.

Government — Regulator and Provider

Government plays multiple roles in the mixed economy: it sets the rules of the economic game (property rights, contract law, competition law, consumer protection); provides public goods that markets underprovide (national defence, policing, basic infrastructure); corrects market failures (regulating externalities like pollution, providing information); redistributes income (through taxation and social spending); and manages macroeconomic stability (through fiscal and monetary policy).

In South Africa, government's role is particularly significant through: BEE policy (shaping ownership patterns and procurement decisions), labour regulation (setting minimum wages and employment conditions), state-owned enterprise management (Eskom, Transnet, SAA), and social grant provision. The entrepreneur who understands government's role can anticipate regulatory changes, access government support programmes, and design their venture to comply efficiently with applicable requirements.

1.6 Perfect versus Imperfect Markets — A South African Perspective

In theory, a perfect market exists when: prices are fully transparent and instantly known by all participants; buyers and sellers are matched immediately; there are no transaction costs; there are no externalities; and no single buyer or seller can influence the price. In practice, no market meets all these conditions — all real markets are imperfect to some degree.

South Africa's markets exhibit a range of imperfections that create both risks and opportunities for entrepreneurs:

Imperfection Type	Entrepreneurial Implication
Information asymmetry	Sellers often know more about product quality than buyers — creating opportunities for trust-based differentiation.
High market concentration	Many SA industries are dominated by a few large players — creating niche opportunities for specialist entrants.
Geographic barriers	Serving rural and township markets is underinvested due to logistics complexity — representing significant entrepreneurial opportunity.
Collusion	The Competition Commission regularly investigates and penalises cartel behaviour in sectors including banking, construction, and food retailing.
State intervention	Regulatory requirements, BEE policy, and SOE competition shape market outcomes in ways that pure market theory does not predict.
Capital market imperfections	Access to finance is highly unequal — an imperfection that creates both barrier and opportunity for the well-networked entrepreneur.

Section 2: Supply, Demand, and Price Determination

Supply and demand are the twin engines of the market economy. Every price — from the rent you pay to the salary you earn to the petrol in your vehicle — is determined by the interaction of supply and demand. Understanding these forces is not just economic theory: it is the foundation of every pricing decision, inventory strategy, and market entry decision an entrepreneur makes.

2.1 The Law of Demand

The Law of Demand states: *all else being equal, when the price of a good rises, the quantity demanded falls; when the price falls, quantity demanded rises.* The demand curve slopes downward from left to right — as price increases, fewer units are purchased.

Why does demand fall when price rises? Because every purchase involves an opportunity cost — spending money on one thing means not spending it on something else. As the price of a good rises, more consumers decide that the opportunity cost is too high and redirect their spending elsewhere.

> *The Law of Demand has direct implications for the entrepreneur: if you raise your price, you must have a reason to believe that your product is differentiated enough that customers will absorb the increase rather than switch to an alternative. If you lower your price, you must have a reason to believe that the additional volume generated will more than compensate for the lower margin per unit.*

2.2 The Law of Supply

The Law of Supply states: *all else being equal, when the price of a good rises, the quantity supplied increases; when the price falls, quantity supplied decreases.* The supply curve slopes upward from left to right — higher prices incentivise greater production because they generate higher revenue and profit for suppliers.

Why does supply rise when price rises? Higher prices make production more profitable — attracting both increased output from existing producers and new entrants to the market. The apple farmer who can sell at R1 per apple rather than 50 cents will plant more apple trees next season. The software developer who can charge R500 per month for a subscription rather than R200 will invest more in developing and marketing the product.

2.3 Market Equilibrium

Market equilibrium is the price and quantity at which the amount producers are willing to supply exactly equals the amount consumers are willing to buy. At equilibrium, there is no surplus (excess supply) and no shortage (excess demand) — the market 'clears'.

The market constantly moves toward equilibrium through the price mechanism:

When price is above equilibrium (surplus exists):

Quantity supplied exceeds quantity demanded. Unsold stock accumulates. Sellers reduce prices to clear inventory. As prices fall, quantity demanded rises and quantity supplied falls — bringing the market back toward equilibrium.

When price is below equilibrium (shortage exists):

Quantity demanded exceeds quantity supplied. Stock runs out. Some consumers offer to pay more to secure the product. As prices rise, quantity demanded falls and quantity supplied rises — again bringing the market toward equilibrium.

Entrepreneurial implication: if your product is consistently selling out (shortage), you can likely raise your price — you are priced below equilibrium and leaving value on the table. If your product is not selling (surplus), you may need to reduce price or improve the product to bring demand up to your supply level.

2.4 Shifts versus Movements in Supply and Demand

A critical distinction that many business owners miss is the difference between a 'movement along' a curve (caused purely by a price change) and a 'shift of' a curve (caused by a non-price factor that changes the quantity demanded or supplied at every price level):

Type	Cause	Effect on Curve	Entrepreneurial Example
Movement along demand curve	Change in the product's own price	Movement along existing curve (no shift)	You raise your restaurant's prices — fewer customers per evening
Shift of demand curve	Change in income, preferences, prices of related goods, expectations, or demographics	Entire curve moves left (demand falls) or right (demand rises)	Economic recession reduces household income — demand for restaurant meals falls at every price
Movement along supply curve	Change in the product's own price	Movement along existing curve	Higher restaurant revenues attract more restaurant openings
Shift of supply curve	Change in input costs, technology, number of producers, or government policy	Entire curve moves left (supply falls) or right (supply rises)	Load-shedding increases your production costs — supply falls at every price

2.5 Factors That Cause Demand Curves to Shift

Understanding what shifts demand enables the entrepreneur to anticipate market changes rather than simply react to them:

Consumer Income: Rising income shifts demand right (more demand at every price) for normal goods. Falling income shifts demand left. South Africa's income growth projections are therefore a key indicator for businesses selling non-essential goods and services.

Prices of Substitute Goods: If the price of a close substitute falls, demand for your product falls (shifts left). If a substitute becomes more expensive, demand for your product rises. The entrepreneur who does not monitor substitute prices will be blindsided by demand shifts they cannot explain.

Prices of Complementary Goods: If a product that is consumed together with yours (a complement) becomes more expensive, demand for your product falls. Petrol price rises reduce demand for car-related services. Coffee price rises may reduce demand for coffee cups.

Consumer Preferences and Tastes: Shifts in fashion, culture, health awareness, or social norms can dramatically shift demand curves. The shift toward plant-based diets has shifted demand right for plant protein products and left for processed meat products.

Population and Demographics: Growing populations shift demand right for most goods. Ageing populations shift demand right for healthcare and financial services. Urbanisation shifts demand right for urban convenience products and services.

Consumer Expectations: If consumers expect prices to rise in the future (as in an inflationary environment), they increase current demand — shifting the demand curve right. This is one reason why expectations management matters in monetary policy.

Advertising and Marketing: Effective marketing shifts the demand curve right — more consumers want the product at every price. This is why advertising spend is classified as an investment, not just a cost.

Seasonal and Cyclical Factors: December tourism demand in the Cape shifts demand curves right for accommodation and restaurants. The pre-school season shifts demand right for stationery and uniforms. Understanding seasonality enables proactive capacity and pricing planning.

2.6 Factors That Cause Supply Curves to Shift

Supply curves shift when the cost or ability to produce changes at every price level:

Input Costs (Labour, Raw Materials, Energy): Rising input costs shift the supply curve left — producers supply less at every price because costs have increased. Minimum wage increases, commodity price spikes, and electricity tariff hikes all shift supply left for affected businesses.

Technology and Productivity: Technological improvements shift supply right — producers can supply more at the same cost (or the same quantity at lower cost). Digital tools, automation, and process improvements all shift supply curves right for businesses that adopt them.

Number of Producers: As more businesses enter a market, total market supply shifts right. As businesses exit (through failure or consolidation), supply shifts left. Load-shedding-induced business failures shift supply left in affected markets.

Government Policy: Taxes shift supply left (raising the cost of production). Subsidies shift supply right (lowering the cost). Regulations that require compliance investment shift supply left. Deregulation typically shifts supply right.

Natural Events: Droughts shift supply left for agricultural products. Disease outbreaks shift supply left in affected industries. Unusually good growing seasons shift supply right.

Supplier Expectations: If producers expect future prices to be higher, they may reduce current supply (holding stock for a better price) — shifting the current supply curve left.

2.7 The Four Factors of Production

Every product or service requires inputs to produce. Economists classify these inputs into four categories, known as the factors of production. Understanding them helps the entrepreneur identify costs, plan resources, and understand the structural economics of their industry:

Land — Natural Resources

Land in economic terms encompasses all natural resources used in production: the physical land itself, mineral deposits, water, forests, fisheries, and agricultural land. Land is a fixed resource in absolute terms — the total amount of land on Earth does not change — but its economic value varies enormously based on location, accessibility, and the resources it contains.

For the South African entrepreneur, 'land' includes: commercial and industrial property (leased or owned), access to natural resources (water for a food business, raw materials for a manufacturer), and proximity to natural resource deposits that affect logistics costs. South Africa's natural resource endowment — minerals, agricultural land, biodiversity, coastline — represents a significant source of comparative advantage in the global economy.

Labour — Human Capital

Labour represents the human effort — physical and intellectual — invested in production. The quality of labour depends on education, training, experience, health, and motivation. Human capital — the accumulated skills and knowledge of the workforce — is the most important determinant of long-term economic productivity and growth.

Labour challenges for the South African entrepreneur: relatively high minimum wages by developing-country standards; rigid labour legislation that increases the cost of both hiring and dismissal; a significant skills shortage in technical, engineering, and management disciplines; high youth unemployment that creates a large pool of entry-level labour but requires investment in training and development.

Capital — Produced Means of Production

Capital has two economic meanings: physical capital (the tools, machinery, buildings, technology, and equipment used to produce goods and services) and financial capital (the money used to acquire physical capital and fund operations).

Physical capital distinguishes modern production from subsistence production: a baker with a commercial oven produces thousands of loaves where a baker with no equipment produces tens. The accumulation of physical capital — through investment — is the primary mechanism by which labour productivity increases and living standards rise.

For the entrepreneur, capital planning involves: identifying all physical assets required; deciding between purchase and lease; planning the depreciation and replacement cycle; and ensuring adequate working capital to bridge the gap between spending on inputs and receiving payment for outputs.

Entrepreneurship — The Organising Factor

Entrepreneurship is the factor of production that brings the other three together and converts them into value. The entrepreneur identifies the opportunity, organises the resources (land, labour, and capital), bears the risk of the venture, and manages the enterprise toward its objectives.

Entrepreneurship is a scarce resource — not everyone has the vision, courage, resilience, and skill to successfully organise the other factors of production into a viable business. This scarcity is what justifies the entrepreneurial return: profit. Profit is not an exploitation of workers or customers — it is the economic reward for successfully bearing uncertainty and creating value that others value.

The quality of a country's entrepreneurship — its culture of enterprise, the skills of its entrepreneurs, and the ecosystem that supports them — is a critical determinant of economic dynamism and job creation.

2.8 The Role of Money in the Economy

Modern economic exchange is made possible by money. Without a medium of exchange, every transaction would require a 'double coincidence of wants' — the seller of apples would need to find a buyer who happens to have exactly what the apple seller wants in return. Money eliminates this barrier and enables the specialisation and trade that underpin economic prosperity.

Money performs four essential functions in the economy:

Function	What It Enables	Entrepreneurial Implication

Medium of Exchange	Money is accepted in payment for all goods and services, eliminating the need for barter and enabling specialisation. Without this function, complex modern economies would be impossible.	Failure to manage your cash — 'the blood of the business' — is the leading cause of business failure in South Africa
Store of Value	Money enables the separation of the timing of earning from the timing of spending. You can work this month and spend next month because money retains value over time (subject to inflation eroding that value).	Inflation erodes the real value of cash savings and receivables
Unit of Account	Money provides a common measure of value that enables comparison. Without a unit of account, you cannot meaningfully compare the value of a kilo of apples with an hour of legal advice — money makes this comparison possible.	Your financial statements use money as a unit of account to compare performance across periods
Standard of Deferred Payment	Money enables credit — the ability to receive something now and pay later. This is foundational to investment, trade credit, and the entire financial system.	Trade credit and bank loans depend on money's store of value function

Money circulates through three interconnected levels of the economy: the government (receives money through taxation; spends on services and infrastructure), businesses (receive money through sales; spend on wages, materials, and investment), and individuals (receive money through wages and investment returns; spend on goods and services). When any of these flows breaks down — when firms don't sell, when government has no tax revenue, when consumers have no income — the entire circular flow contracts and recession follows. The entrepreneur's business is both a participant in and a beneficiary of this circular flow. Businesses that create employment and distribute wages are contributing directly to the demand that sustains their own sales.

Section 3: Factors That Influence Economic Activity

Economic activity is not constant — it rises and falls in predictable patterns known as business cycles, and is influenced by a range of macroeconomic variables that every entrepreneur must understand and monitor. The entrepreneur who understands the economic cycle and its drivers can plan proactively — adjusting strategy, cash flow, and inventory ahead of economic shifts rather than reacting to them in crisis.

3.1 The Business Cycle

Economic output does not grow in a straight line — it fluctuates in a wave-like pattern known as the business cycle. The four phases of the business cycle create very different business environments:

Prosperity / Boom

GDP is growing strongly. Employment is high. Consumer confidence is elevated. Business investment is expanding. Credit is readily available. Demand is strong across most sectors. For the entrepreneur, this is the phase of greatest opportunity — demand is growing, credit is accessible, and the cost of failure is lower because good times create a more forgiving competitive environment. The danger: overexpansion during boom conditions leaves businesses vulnerable when the cycle turns.

Recession

GDP growth slows (technically, a recession is two consecutive quarters of negative GDP growth). Unemployment rises. Consumer confidence falls. Business investment contracts. Credit tightens. Demand weakens, particularly for discretionary goods and services. For the entrepreneur, recession demands: aggressive cash flow management, cost reduction, focus on cash-generative core activities, and cautious expansion. Recessions also create opportunities: distressed assets, talent released by larger companies, and underserved customers looking for better value.

Depression

A prolonged and severe recession. GDP has fallen significantly and recovery is slow. Unemployment is very high. Consumer demand is severely depressed. Credit is extremely tight. Few businesses emerge from a depression unscathed. The COVID-19 pandemic triggered conditions approaching depression in many sectors — hospitality, aviation, and entertainment — providing sobering evidence of how extreme economic disruption can be even for well-managed businesses.

Recovery

GDP begins to grow again. Employment starts to rise. Consumer confidence returns gradually. Investment begins to expand. This phase rewards entrepreneurs who maintained their businesses through the recession — they are positioned to capture growing demand before competitors who did not survive have rebuilt. The recovery phase is often the ideal time for strategic investment — before the boom phase drives up input costs and competition for resources.

Cyclical versus Non-Cyclical Businesses

Understanding whether your business is cyclical or non-cyclical is critical for strategic planning and risk management:

Business Type	Characteristics	SA Examples	Strategic Implication
Cyclical	Performance closely tied to economic cycle — strong in booms, weak in recessions	Construction, auto sales, luxury retail, hospitality, advertising agencies	Build cash reserves in booms to survive recessions; invest counter-cyclically
Non-Cyclical (Defensive)	Demand relatively stable regardless of economic cycle	Food retail, healthcare, utilities, essential services, basic clothing	More predictable cash flows; often lower margins but greater resilience
Counter-Cyclical	Performance improves in recessions (as consumers seek cheaper alternatives)	Discount retailers, debt collection, repo markets, budget accommodation	Contrarian positioning; may underperform in booms but outperform in downturns

3.2 Inflation — The Silent Tax on Business

Inflation is the sustained rise in the general level of prices in an economy over time. As prices rise, each unit of currency buys fewer goods and services — eroding the real value of money, savings, and fixed-price contracts. Understanding inflation is essential for the entrepreneur because it affects virtually every aspect of business planning: pricing, cost management, salary negotiations, loan repayment, and investment returns.

Causes of Inflation

Demand-Pull Inflation: When aggregate demand in the economy exceeds the productive capacity of the economy, prices are bid up. This is 'too much money chasing too few goods.' In South Africa, strong consumer credit growth in the 2000s was a demand-pull inflationary force.

Cost-Push Inflation: When the cost of production inputs rises, businesses pass these costs on through higher prices. Oil price spikes, electricity tariff increases, and minimum wage increases are all cost-push inflationary forces that South African businesses regularly experience.

Money Supply Growth: When the central bank increases the money supply faster than the growth of real output, too much money chases too few goods — generating inflation. Zimbabwe's hyperinflation (2007-2009) was a catastrophic example of excessive money printing.

Expectations: If businesses and consumers expect inflation, they behave in ways that make it a self-fulfilling prophecy — workers demand higher wages, businesses raise prices preemptively. Breaking an inflation expectations spiral is one of the most difficult challenges in monetary policy.

Exchange Rate Depreciation: A weaker currency makes imports more expensive — directly raising prices in an import-dependent economy like South Africa's. The rand's weakness against the dollar and euro is a chronic inflationary force in South Africa.

Impact of Inflation on New Ventures

- ✥ Rising input costs compress profit margins if selling prices cannot be raised at the same rate.
- ✥ Salary pressure — employees demand cost-of-living adjustments to maintain real income.
- ✥ Higher interest rates (typically used to combat inflation) increase the cost of business loans and reduce consumer spending on credit.
- ✥ Erosion of the real value of receivables — the longer customers take to pay, the less the payment is worth in real terms.
- ✥ Uncertainty that makes medium and long-term financial planning and investment more difficult.
- ✥ Potential for 'bracket creep' — the business's nominal profits rise but real profits may be flat or declining.

3.3 Exchange Rates and the Currency

The exchange rate is the price of one currency in terms of another. For South African entrepreneurs — whether importing supplies, exporting products, or competing against imported goods — the rand exchange rate is one of the most important macroeconomic variables to monitor.

How Exchange Rate Changes Affect Business

Rand depreciation (rand weakens against dollar/euro)

- ◆ Imported goods and services become more expensive in rand terms — increasing input costs for businesses that import raw materials, equipment, or components.
- ◆ South African exports become cheaper for foreign buyers — improving the competitiveness of export-oriented businesses.
- ◆ Tourism from abroad increases as South Africa becomes cheaper for visitors — benefiting the hospitality sector.
- ◆ Domestic inflation rises as import prices feed through to consumer prices.

Rand appreciation (rand strengthens against dollar/euro)

- ◆ Imported goods become cheaper — reducing input costs for import-dependent businesses.

◆ South African exports become more expensive for foreign buyers — reducing export competitiveness.

◆ Inflation is moderated as import prices fall.

◆ Foreign tourists find South Africa more expensive — potentially reducing inbound tourism.

Determinants of the Rand Exchange Rate

The rand is one of the world's most volatile currencies — understanding what drives it helps entrepreneurs anticipate and hedge their currency exposure:

Commodity prices: South Africa is a major commodity exporter (platinum, gold, coal, iron ore). Rising commodity prices attract foreign exchange into South Africa, strengthening the rand.

Interest rate differentials: Higher South African interest rates (relative to major economies) attract foreign capital seeking yield — strengthening the rand. SARB rate decisions are therefore closely watched by currency traders.

Current account balance: A large current account deficit (importing more than exporting) requires capital flows to finance it — if those flows stop, the rand depreciates.

Political stability: Political uncertainty drives capital out of South Africa, weakening the rand. Elections, policy uncertainty, and governance failures all put downward pressure on the currency.

Global risk appetite: During periods of global financial stress, emerging market currencies including the rand typically weaken as investors flee to 'safe haven' currencies like the US dollar, Swiss franc, and Japanese yen.

3.4 Key Economic Indicators Every Entrepreneur Should Monitor

Indicator	What It Measures	Entrepreneurial Relevance
Gross Domestic Product (GDP)	Total market value of all goods and services produced in South Africa in a year	GDP growth rate signals overall economic health and consumer demand trajectory
CPI (Consumer Price Index)	Measure of inflation — the change in price level of a basket of consumer goods	Drives input costs, salary demands, and consumer purchasing power
Repo Rate (SARB)	The rate at which the Reserve Bank lends to commercial banks; sets the floor for all borrowing rates	Affects cost of business loans, consumer credit appetite, and investment decisions

Prime Rate	Repo rate + 3.5%; the benchmark lending rate for most business loans	Directly determines the interest cost of overdrafts and variable-rate business loans
Unemployment Rate	Percentage of labour force seeking but unable to find employment	High unemployment signals weak consumer demand; also indicates abundant labour supply
Rand/Dollar Exchange Rate	Price of the rand in US dollars	Affects import costs, export competitiveness, and inflation through imported goods
Balance of Payments	Record of all financial transactions between South Africa and the rest of the world	A persistent current account deficit puts pressure on the rand
Load-Shedding Stage	Level of planned electricity outages	Directly impacts operational costs, productivity, and customer footfall
Business Confidence Index	Survey of business owners' expectations about future conditions	Leading indicator of investment and hiring decisions

Section 4: The Development and Significance of Markets

Markets do not develop randomly — they emerge from the uneven distribution of resources, the specific capabilities of communities and nations, the socio-economic conditions of populations, and the structural characteristics of the economy. For the South African entrepreneur, understanding these market development dynamics reveals both the structural challenges and the extraordinary growth opportunities that this economy presents.

4.1 International Trade and Uneven Resource Distribution

No country has everything it needs to produce all the goods and services its population demands. Countries differ in their endowments of natural resources, labour quality, capital stock, climate, geography, and technological capability. These differences are the root cause of international trade — nations specialise in producing what they do best (their comparative advantage) and trade to obtain what they do not produce as efficiently.

> *The Theory of Comparative Advantage: A country has a comparative advantage in producing a good if it can produce it at a lower opportunity cost than trading partners — even if it is not the most efficient producer in absolute terms. Trading according to comparative advantage makes all trading partners better off than attempting self-sufficiency.*

International Trade Opportunities for South African Entrepreneurs

Mining and Minerals

South Africa holds some of the world's largest reserves of platinum, chromium, vanadium, manganese, and gold. The mining sector and downstream beneficiation represent significant export opportunity — particularly as global demand for platinum group metals grows with fuel cell and hydrogen technology adoption.

Agriculture and Agro-processing

South Africa's agricultural sector produces high-quality wine, citrus, deciduous fruit, macadamias, avocados, and a range of other high-value commodities with strong export demand. Agro-processing — adding value to agricultural output through processing, packaging, and branding — represents a particularly high-growth opportunity.

Financial Services

South Africa's financial sector is among the most sophisticated on the African continent. South African financial institutions, insurers, and asset managers are well-positioned to serve the growing financial services demand across sub-Saharan Africa.

Tourism

South Africa's natural beauty, biodiversity, cultural richness, and wine routes create world-class tourism assets. The sector represents a major foreign exchange earner and a significant entrepreneurial opportunity for accommodation, food, transport, and experience businesses.

Technology and Software

South Africa's tech sector is growing rapidly. The country produces strong software developers, cybersecurity professionals, and fintech innovators who are increasingly competitive in global markets, particularly where the rand exchange rate provides a cost advantage.

African Market Opportunities

South Africa's position as the gateway to sub-Saharan Africa gives its entrepreneurs preferential access to one of the world's fastest-growing consumer markets. The African Continental Free Trade Area (AfCFTA) is progressively reducing trade barriers, creating new market access for South African businesses.

BEE and New Venture Creation

Broad-Based Black Economic Empowerment (BEE) policy is one of the most significant government interventions shaping the South African business environment. It affects procurement decisions, ownership requirements, employment equity, skills development, and enterprise development. Understanding BEE is not optional for the South African entrepreneur — it shapes the competitive landscape, creates specific opportunities for qualifying entrepreneurs, and imposes compliance obligations on businesses operating in regulated sectors or tendering for government contracts.

Ownership: Businesses can improve their BEE score by having a meaningful percentage of equity held by black South Africans. This creates opportunity for BEE transactions and black-owned ventures.

Management Control: Having black South Africans in senior management and board positions improves the BEE score. This creates demand for senior black business leaders.

Skills Development: Spending on training and development for black employees improves the BEE score. This creates demand for accredited training providers.

Enterprise and Supplier Development: Corporations are incentivised to support black-owned SMEs through preferential procurement, mentorship, and financial support. This creates significant market access opportunities for qualifying enterprises.

Socio-Economic Development: Contributions to social development initiatives by businesses with a BEE focus. Corporate social investment creates market access for NGOs and social enterprises.

4.2 South Africa's Socio-Economic Context and Entrepreneurship

South Africa faces extraordinary socio-economic challenges that simultaneously represent significant obstacles and significant opportunities for entrepreneurship. Understanding these dynamics is essential for building a venture that is both commercially viable and socially relevant:

Unemployment Crisis

South Africa's unemployment rate consistently exceeds 30% (and youth unemployment exceeds 60% by the expanded definition). This is simultaneously a massive social problem and an entrepreneurial opportunity — the economy urgently needs more businesses that create employment. Every successful new venture is a partial solution to the unemployment crisis.

For the entrepreneur, high unemployment means: a large pool of potential employees at entry-level wages; the moral responsibility that comes with being an employer; and the commercial opportunity in products and services targeted at working-class and lower-income South Africans who represent the majority of the population.

Income Inequality

South Africa has one of the highest Gini coefficients in the world — measuring income inequality. The wealthiest 10% earn approximately 65% of all income, while the poorest 40% earn approximately 6%. This creates a highly segmented market where mass-market products targeted at lower-income consumers have far more potential customers but lower average spending, while premium products have fewer customers with much higher spending.

The entrepreneurial opportunity in inequality: serving the rising black middle class (which has grown significantly since 1994), building township economy businesses, and creating products that make quality goods accessible to lower-income consumers through affordable pricing, flexible payment terms, or shared-access models.

Skills Gap and Education

Despite the expansion of formal education since 1994, a significant skills mismatch persists between the skills produced by the education system and the skills required by the economy. Technical skills, STEM disciplines, and management capability are in short supply relative to demand.

For the entrepreneur, the skills gap is a challenge (finding the right people is hard and expensive) and an opportunity (accredited training, learnerships, and workplace education are commercially viable and BEE-score-enhancing).

Township Economy

South Africa's townships and informal settlements are home to approximately 38% of the population — a large, growing, and underserved market that formal businesses have historically neglected. The township economy is characterised by strong community networks, established informal trade, significant cash turnover, and growing middle-class aspirations.

Entrepreneurs who understand and respect township culture while offering genuine value can access a massive market that is underserved by formal businesses — from financial services to healthcare to food and beverage to digital access to education.

4.3 Growth Sectors for New Ventures in South Africa

The following sectors offer the most compelling structural growth opportunities for South African entrepreneurs over the next decade:

Renewable Energy and Energy Efficiency

South Africa's electricity crisis — characterised by chronic load-shedding from an ageing and poorly maintained Eskom fleet — has created an enormous entrepreneurial opportunity in solar energy, battery storage, energy efficiency consulting, and distributed generation. The government's Renewable Energy Independent Power Producer Programme (REIPPP) has attracted billions in investment. At the small business level, solar installers, energy efficiency auditors, and battery system integrators are among the fastest-growing businesses in South Africa. Every home and business owner facing load-shedding is a potential customer.

Agriculture and Agro-processing

South Africa's agricultural sector — despite employing only about 5% of the formal workforce — is a significant export earner and food security foundation. Agro-processing (adding value to agricultural output through processing, packaging, and branding) is significantly underdeveloped relative to the raw agricultural base. Opportunities exist in: specialty food production and packaging, organic and premium food products, cold chain logistics for perishables, export preparation and compliance services, irrigation and agricultural technology, and agritourism and farm experiences.

Healthcare and Wellness

South Africa's dual healthcare system — a strained public sector and a growing private sector — creates significant demand for private healthcare services across a range of income levels. The National Health Insurance (NHI) policy, if implemented, will significantly expand demand for primary healthcare services. Opportunities include: primary healthcare clinics in underserved areas, health and wellness products, homecare services, medical technology, telemedicine, and pharmaceutical distribution.

Technology and Digital Services

South Africa's technology sector is growing rapidly, driven by increasing smartphone penetration, expanding broadband access, and a growing digital economy. Opportunities include: software development and IT services (particularly serving the rest of Africa), e-commerce (both as a direct-to-consumer channel and as a platform service), digital marketing, cybersecurity, cloud computing services, and edtech (online education).

Construction and Affordable Housing

South Africa faces a housing backlog of over 2 million units. Government's commitment to social housing and the growing demand for affordable urban accommodation create strong structural demand for construction services, building materials, and housing finance. The infrastructure investment planned for roads, water, and energy also creates significant construction demand.

Tourism and Hospitality

South Africa's natural assets — wildlife, scenery, biodiversity, wine, and cultural heritage — are globally recognised as world-class. The tourism sector, devastated by COVID-19, is recovering and creating opportunities for new accommodation concepts, experience tourism, community-based tourism, and food and beverage businesses that leverage South Africa's cultural diversity and culinary richness.

Financial Services for the Underserved

Despite progress, a significant portion of South Africans remain underbanked or underinsured. Fintech companies are addressing this through mobile money, microinsurance, digital lending, and savings platforms. The opportunity lies in using technology to serve customers cost-effectively at low transaction sizes and high volumes — the 'bottom of the pyramid' market that traditional financial institutions have found unprofitable to serve.

Clothing, Textiles, and Fashion

South Africa's clothing and textile industry employs significant numbers and produces for both domestic and export markets. The sector benefits from AGOA (African Growth and Opportunity Act) trade preferences with the United States. Local fashion brands that authentically reflect South African and African cultural identity are finding growing domestic and international audiences.

1.7 South African Competition Law and Policy

The Competition Act (89 of 1998) established the Competition Commission, Competition Tribunal, and Competition Appeal Court to promote and maintain competition in South Africa. Understanding competition law is essential for every entrepreneur — both to avoid inadvertent violations and to understand the protections it affords against anticompetitive behaviour by larger players.

Area	Description and Entrepreneurial Implication
Prohibited Practices	The Act prohibits two categories of anticompetitive conduct: restrictive horizontal practices (agreements between competitors that fix prices, divide markets, or collude on tenders — which are per se prohibited with no justification possible) and restrictive vertical practices (agreements between suppliers and customers that foreclose markets or fix resale prices — which may be justified by efficiency benefits).
Abuse of Dominance	A firm with a dominant position (generally above 45% market share) is prohibited from charging excessive prices, preventing competition through exclusionary acts, or engaging in price discrimination that impedes competition. This provision protects smaller businesses from being crushed by dominant incumbents.
Merger Regulation	Transactions that result in a change of control must be notified to and approved by the Competition Commission above certain turnover thresholds. Mergers that substantially prevent or lessen competition may be prohibited or approved subject to conditions.
Cartel Conduct	Price fixing, market division, and bid rigging between competitors are among the most seriously prosecuted offences under South African competition law. Penalties can reach 10% of annual turnover. Individual managers may be criminally prosecuted. The construction sector, banking sector, and food retail sector have all faced major cartel investigations.
Implications for Entrepreneurs	If your business operates in a market where a dominant supplier is engaging in exclusionary conduct, you can complain to the Competition Commission. If you are acquiring another business, check whether merger notification is required. Never agree with competitors on prices, markets, or tender bids — even informally.

Regulatory Bodies Shaping South African Markets

Beyond competition law, a range of sector-specific regulatory bodies shape the competitive environment in South Africa. Understanding which regulators oversee your sector — and what they require — is essential for both compliance and strategic planning:

Regulator	Sector and Key Obligations
National Energy Regulator of SA (NERSA)	Regulates the electricity, piped gas, and petroleum pipeline industries. NERSA approves Eskom's tariff increases — directly affecting every business's electricity costs.

Independent Communications Authority of SA (ICASA)	Regulates telecommunications, broadcasting, and postal services. Controls spectrum licensing and sets interconnection regulations that affect mobile and internet service pricing.
Financial Sector Conduct Authority (FSCA)	Regulates financial services providers, insurance companies, and investment managers. All businesses providing financial advice or products must hold an FSP licence from the FSCA.
South African Pharmacy Council (SAPC)	Regulates the practice of pharmacy and the operation of pharmacies. Any business dispensing medicines must comply with SAPC requirements.
National Credit Regulator (NCR)	Regulates credit providers under the National Credit Act. Any business offering credit must register with the NCR and comply with responsible lending requirements.
Competition Commission	Investigates anticompetitive conduct and reviews mergers. Businesses in concentrated markets should understand the Commission's enforcement priorities in their sector.
Companies and Intellectual Property Commission (CIPC)	Registers companies, intellectual property, and business names. All formal businesses must maintain their registration in good standing with CIPC.

Chapter Summary

❖ Every entrepreneur operates within an economic system. South Africa's mixed economy combines private market forces with government regulation, state ownership of key enterprises, and significant social redistribution through grants and public services.

❖ The four major economic systems — market, socialist, command, and mixed — represent different answers to the fundamental questions of what to produce, how to produce it, and for whom.

❖ Competition in a free market drives lower prices, greater efficiency, innovation, and economic restructuring — all of which benefit consumers and create entrepreneurial opportunity.

❖ Real markets are imperfect. The four main market structures — perfect competition, monopolistic competition, oligopoly, and monopoly — represent different levels of competitive intensity and market power.

❖ Three economic roleplayers interact to shape market outcomes: consumers (demand side), producers (supply side), and government (regulator and provider).

❖ The Law of Demand states that quantity demanded falls as price rises. The Law of Supply states that quantity supplied rises as price rises. Market equilibrium is where supply and demand are equal.

❖ Demand curves shift when non-price factors change: income, substitute prices, complement prices, preferences, demographics, expectations, and advertising.

❖ Supply curves shift when production conditions change: input costs, technology, number of producers, government policy, and natural events.

❖ The four factors of production — land, labour, capital, and entrepreneurship — are the inputs that all productive activity requires. Entrepreneurship is the organising factor that brings the others together.

❖ Money performs four functions: medium of exchange, store of value, unit of account, and standard of deferred payment. Cash flow management — ensuring the business never runs out of money — is the most critical operational discipline.

❖ The business cycle has four phases: prosperity, recession, depression, and recovery. Understanding the cycle enables proactive rather than reactive business strategy.

❖ Inflation erodes purchasing power, raises input costs, drives salary demands, and increases interest rates. Managing inflation exposure through pricing strategy, cost management, and hedging is essential.

❖ Exchange rates affect import costs, export competitiveness, and inflation. The rand's volatility requires South African entrepreneurs to monitor and manage currency exposure.

❖ Key economic indicators to monitor: GDP growth rate, CPI inflation, SARB repo rate, prime rate, unemployment rate, rand exchange rate, load-shedding levels, and business confidence index.

❖ International trade arises from uneven resource distribution and comparative advantage. South Africa's comparative advantages include mineral resources, agricultural products, biodiversity, and financial services capability.

❖ BEE policy creates specific market opportunities for qualifying entrepreneurs through preferential procurement, enterprise development support, and ownership transformation requirements.

❖ South Africa's socio-economic challenges — unemployment, inequality, skills gaps, and the township economy — represent both structural risks and significant entrepreneurial opportunities.

❖ Eight growth sectors offer compelling opportunities for South African entrepreneurs: renewable energy, agriculture and agro-processing, healthcare, technology, construction, tourism, financial services for the underserved, and fashion.

Application Exercise: Choose one growth sector identified in Section 4. (1) Research its current size and growth rate in South Africa. (2) Identify the key supply and demand factors currently shaping the market. (3) Apply the Five Forces model to assess the competitive dynamics. (4) Identify the top three entrepreneurial opportunities within the sector that align with your skills and interests. This analysis forms part of your market environment section in the Chapter 6 business plan.