

1 BUSINESS ORGANISATION AND ENVIRONMENT

01 The nature of business activity

This chapter covers syllabus section 1.1

On completing this chapter you should be able to:

- understand what business activity involves
- identify inputs, outputs and processes of a business
- identify and explain the main business functions
- identify and explain the main sectors of industry
- analyse the impact on business activity of changes in economic structure.

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SETTING THE SCENE

Dulip starts his business

Dulip lives in a large country which has many natural resources such as coal and timber. He plans to start a business growing and cutting trees to sell as timber. He wants to buy a forest from a farmer and cut down a fixed number of trees each year. As Dulip is concerned about the environment of his country, he will plant two new trees for each one he cuts down.

He has contacted suppliers of saws, tractors and other equipment to check on prices. He plans to employ three workers to help him with much of the manual work. Dulip has also visited several furniture making companies to see if they would be interested in buying wood from him and he has even visited furniture shops to see which types of wood sell best. He has arranged a bank loan for much of the capital that he will need to get started.

Points to think about:

- Why do you think Dulip decided to own and run his own business rather than work for another firm?
- What resources (or inputs) does Dulip need to run his business successfully?
- What do you think are the essential differences between these three businesses: Dulip's forestry business; a furniture manufacturer; a shop selling furniture?

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Introduction

This chapter explains what a business is and what businesses do. It outlines the main business functions (or departments) and explains the differences between primary, secondary and tertiary sectors of industry.

Higher Level additional material analyses the impact on business activity of changes in economic structure.

What is a business?

A business is any organisation that uses resources to meet the needs of customers by providing a product or service that they demand. There are several stages in the production of finished goods. Business activity at all stages involves adding value to resources such as raw materials and semi-finished goods and making them more desirable to – and thus valued by – the final purchaser. Without business activity we would all still be entirely dependent on the goods that we could make or grow ourselves – as people in some communities still are. Business activity uses the scarce resources of our planet to produce goods and services that allow us all to enjoy a much higher standard of living than would be possible if we remained entirely self-sufficient.

What do businesses do?

Businesses identify the needs of consumers or other firms. They then purchase resources, which are the inputs of the business, or factors of production, in order to produce output. The ‘outputs’ of a business are the goods and services that satisfy consumers’ needs, usually with the aim of making a profit. Business activity exists to produce goods or services, which can be classified in several ways: consumer goods, consumer services and capital goods.

KEY TERMS

consumer goods the physical and tangible goods sold to the general public. They include cars and washing machines, which are referred to as durable consumer goods. Non-durable consumer goods include food, drinks and sweets that can only be used once.

consumer services non-tangible products that are sold to the general public and include hotel accommodation, insurance services and train journeys

capital goods physical goods that are used by industry to aid in the production of other goods and services, such as machines and commercial vehicles

What are business ‘inputs’?

FACTORS OF PRODUCTION

These are the resources needed by business to produce goods or services. Firms will use different combinations of inputs, depending on the product being produced and the size of the business. There are four main inputs:

- **Land** – this general term not only includes land itself but all of the renewable and non-renewable resources of nature, such as coal, crude oil and timber.
- **Labour** – manual and skilled labour make up the workforce of the business. Some firms are labour intensive, that is they have a high proportion of labour inputs to other factors of production, e.g. house cleaning services.
- **Capital** – this consists of the finance needed to set up a business and pay for its continuing operations as well as all of the man-made resources used in production. These include capital goods such as computers, machines, factories, offices and vehicles. Some firms are capital intensive, that is they have a high proportion of capital to other factors of production, e.g. power stations.
- **Enterprise** – this is the driving force of business, provided by risk-taking individuals, which combines the other factors of production into a unit that is capable of producing goods and services. It provides a managing, decision-making and co-ordinating role. Without this essential input, even very high quality land, labour and capital inputs will fail to provide the goods and services that customers need.

Businesses have many other needs before they can successfully produce the goods and services demanded by customers. Figure 1.1 shows the wide range of these needs.

Business functions

Most businesses have four main functional departments. These will be staffed by people with specific qualifications and experience in the work of the functional areas.

MARKETING

This department is responsible for market research and for analysing the results of such research so that consumer wants can be correctly identified. This information will then be discussed with other departments of the business so that the right product decisions are made. Once a product is available for sale, the marketing function will have to make important decisions concerning its pricing, how and where to promote it and how to sell it and distribute it for sale.

FINANCE

This function has responsibility for monitoring the flow of finance into and out of the business, keeping and analysing accounts and providing financial information to both senior management and other departments. Without adequate finance, no effective decisions can be made within the other functional areas, so finance is a key division of any business.

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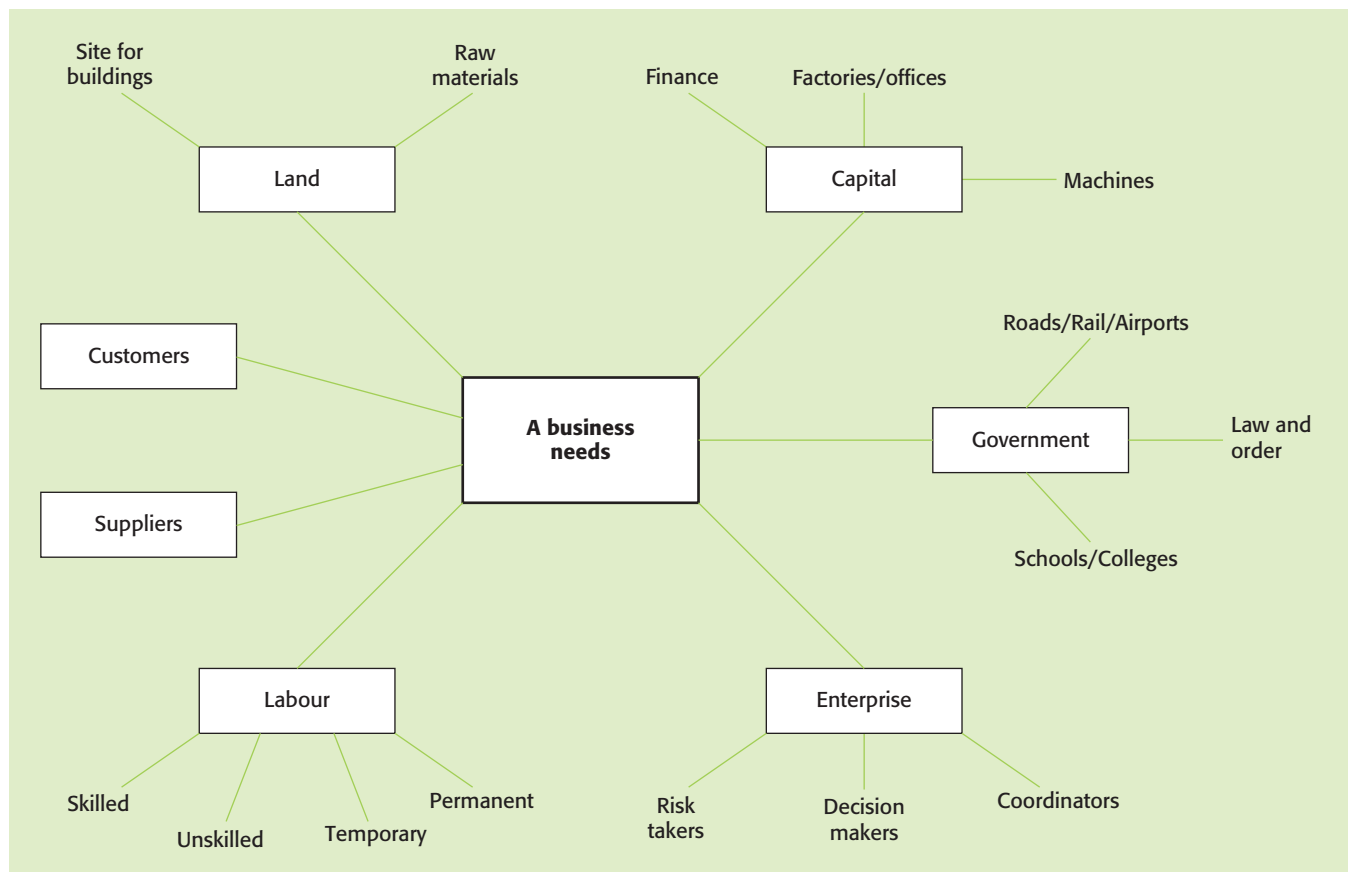


Figure 1.1 What businesses need

HUMAN RESOURCE MANAGEMENT

Human resource (HR) management identifies the workforce needs of the business, recruits, selects and trains appropriate staff and provides motivational systems to help retain staff and encourage them to work productively. It also draws up contracts of employment and covers the redundancy or redeployment of staff if these become necessary.

OPERATIONS MANAGEMENT

Once known simply as the 'production function', operations management has responsibility for ensuring adequate resources are available for production, maintaining production and quality levels and achieving high levels of productive efficiency.

INTERRELATIONSHIP OF FUNCTIONS

It should not be assumed that all business decisions taken within these departments are separate and unconnected

from the other parts of the business. Nothing could be further from reality! Effective strategic decision-making develops from the functions working closely together. Good communication, co-operation and close interrelationships between functions are essential before major decisions are taken. For example, the decision by Peugeot Citroen in 2010 to launch the world's first hybrid diesel car required interaction between:

- marketing – will consumers be prepared to buy this car and at what price?
- finance – do we have the capital needed to develop and produce it?
- HR management – do we need to recruit additional engineers before this project can be turned into a market-ready car?
- operations management – can we produce this product at a cost which allows the marketing department to set a profitable price level?

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Sectors of industry

All production can be classified into three broad types of business activity, or sectors of industry. These categories are also the three stages involved in turning natural resources, such as oil and timber, into the finished goods and services demanded by consumers. The stages are the primary, secondary and tertiary sectors of industry.

KEY TERMS

primary sector business activity firms engaged in farming, fishing, oil extraction and all other industries that extract natural resources so that they can be used and processed by other firms

secondary sector business activity firms that manufacture and process products from natural resources, including computers, brewing, baking, clothing and construction

tertiary sector business activity firms that provide services to consumers and other businesses, such as retailing, transport, insurance, banking, hotels, tourism and telecommunications

Some people also refer to a fourth sector – the ‘quaternary sector’ – which is focused on information technology (IT) businesses and information service providers, but this distinction is not made in the IB syllabus.

The balance of the primary, secondary and tertiary sectors in the economy varies substantially from country to country. It depends on the level of industrialisation in each country. The balance between the sectors is often referred to as a country’s ‘economic structure’. Table 1.1 shows the different economic structures of three countries.

Country	Primary	Secondary	Tertiary
United Kingdom	2	17	81
China	40	28	32
Ghana	53	21	26

Table 1.1 Employment data 2010 – as percentage of total employment



Primary production – dairy cattle following milking



Secondary production – clothing factory in India



Tertiary sector – the breathtaking Burj Al Arab hotel in Dubai

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ACTIVITY 1.1

Business	Primary	Secondary	Tertiary	Description of main activities
Coca-Cola				
HSBC				
FAW (China)				
RTZ				
Wyndham Worldwide				
RR plc				

20 marks, research time

- Copy out this table. Use the internet or other means of research to:
 - identify these well-known international companies
 - identify the **main** sector of industry that they operate in
 - give details of their main activities. [10]
- Research **five** businesses that operate in your country and identify which sector of industry they **mainly** operate in and what their main activities are. [10]

H HIGHER LEVEL

CHANGES IN ECONOMIC STRUCTURE

It is very important to recognise two features of this classification of business activity:

- The importance of each sector in a country's economic structure changes over time. **Industrialisation** describes the growing importance of the secondary sector manufacturing industries in developing countries. The relative importance of each sector is measured in terms either of employment levels or output levels as a proportion of the whole economy. In many countries of Africa and Asia, the relative importance of secondary sector activity is increasing. This brings many benefits as well as problems.

Benefits

- Total national output (Gross Domestic Product) increases and this raises average standards of living.
- Increasing output of goods can result in lower imports and higher exports of such products.
- Expanding manufacturing businesses will result in more jobs being created.
- Expanding and profitable firms will pay more tax to the government.

- Value is added to the country's output of raw materials rather than simply exporting these as basic, unprocessed products.

Problems

- The chance of work in manufacturing can encourage a huge movement of people from the country to the towns, which leads to housing and social problems. It may also result in depopulation of rural areas and problems for farmers in recruiting enough workers.
- The expansion of manufacturing industries may make it difficult for a business to recruit and retain sufficient staff.
- Imports of raw materials and components are often needed, which can increase the country's import costs. Business import costs will vary with changes in the exchange rate.
- Pollution from factories will add to the country's environmental problems.
- Much of the growth of manufacturing industry is due to the expansion of multinational companies. The consequences of this are covered in Chapter 9.

In developed economies, the situation is reversed. There is a general decline in the importance of secondary sector activity and an increase in the tertiary sector. This is known as **deindustrialisation**. In the UK, the proportion of total output accounted

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for by secondary industry has fallen by 15% to 23% in 25 years. The reasons for and possible impact of this change on business include:

- Rising incomes associated with higher living standards have led consumers to spend much of their extra income on services rather than more goods. There has been substantial growth in tourism, hotels and restaurant services, financial services and so on – yet spending on physical goods is rising more slowly.
- As the rest of the world industrialises, so manufacturing businesses in the developed countries face much more competition and these rivals tend to be more efficient and use cheaper labour. Therefore, rising imports of goods are taking market away from the domestic secondary sector firms and many have been forced to close.
- Employment patterns change – manufacturing workers may find it difficult to find employment in other sectors of industry. This is called structural unemployment.

- 2 The relative importance of each sector varies significantly between different economies. Table 1.1 above gives details of the differences that exist between the economies of different countries and the share of total employment accounted for by each sector of industry.

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EXAM TIP

During your IB Business and Management course it is a good idea to read the business section of newspapers regularly. This will help you to apply the work you have done in class to the world outside. What, for example, was the major business story in your country this week?

OVER TO YOU

REVISION CHECKLIST

- 1 What is a 'business'?
- 2 What is a 'business input'?
- 3 Give two examples of primary sector businesses, explaining why they are classified in this sector.
- 4 Give two examples of secondary sector businesses, explaining why they are classified in this sector.
- 5 Give two examples of tertiary sector businesses, explaining why they are classified in this sector.
- 6 Allocate each of these decisions into the appropriate business functional department:
 - a deciding on stock levels for an important raw material
 - b deciding between using shops or a website to sell a new range of clothing
 - c deciding whether to promote a manager from within the business or from another firm
 - d deciding on how to raise \$3 million for a factory expansion.
- 7 Explain why, for a recent major business decision of your choice, it was important for all four business functions to work closely together.
- H 8 Using data from your own country:
 - a How has total output or employment in the secondary sector changed over recent years?
 - b Consider **two** effects of this change on any business in your country.



THEORY OF KNOWLEDGE

Business and Management is considered to be a human science.

- a Explain what you understand by the term human science.
- b Outline the reasons why you think Business and Management is a human science.
- c Using business examples and examples from the natural science(s) you are studying, examine the differences between ways of knowing in human sciences and natural sciences.

REVISION ACTIVITY

BP operates in all three sectors of industry

BP is the third largest oil company in the world. Here are extracts from three recent newspaper articles about the company:

BP ANNOUNCES GIANT OIL WELL DISCOVERY IN THE GULF OF MEXICO

BP is already the largest producer of crude oil and natural gas in the Gulf of Mexico. This new discovery could double the company's reserves in this region of the world.

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BP Kwinana refinery is now the largest refinery in Australia

Significant improvements to this oil refining and processing plant have led to Kwinana becoming one of the most modern in the region, enabling a wide range of fuels to be produced for drivers and for industry, and materials for the plastics and chemical industries.

BP to open 500 more petrol stations in the Jiangsu province of China

A huge new investment by BP in petrol retailing stations will lead to a huge increase in the sales of petrol in China of this large multinational business.

12 marks, 21 minutes

- Using examples from these articles, explain the statement that 'BP operates in all three sectors of industry'. [6]
- Explain why the decision to open 500 new petrol stations in China will involve effective cooperation between all four business functions. [6]

H 10 marks, 18 minutes

- Discuss how changes in the economic structure of Australia could impact on BP's Kwinana refinery. [10]

EXAM PRACTICE QUESTION

Read the case study and then answer the questions that follow.

RECESSION SPARKS NEW BUSINESS IDEAS

Disney, McDonald's, Burger King, Procter & Gamble, Johnson & Johnson, Microsoft – what do they all have in common? They all started during a recession or depression.

The message, delivered to around 40 would-be entrepreneurs at a workshop in Stratford, east London is clear: don't let bad economic headlines put you off. Most of the people at this session are not aiming to create new multinational corporations. But during the coffee break, they seem pretty confident that their ideas can prosper even in the current climate. 'I'm here to find out about starting up a business providing CVs to school leavers,' says Jessica Lyons, wearing a lapel badge with My First CV, the name of the future business, written on it. 'For my particular business idea I think this is the ideal time, because there are more people than ever out there looking for work.'

The recession is causing a spike in interest in setting up small businesses. Another interesting example was from a gym instructor who wants to take his equipment to companies around London, giving people a lunchtime workout without them having to leave their offices. Most of the would-be entrepreneurs in Stratford are looking at potential opportunities in the tertiary sector which don't require large amounts of start-up finance to purchase capital equipment and rely more on their own skills and interests.

Source: Adapted from various sources

25 marks, 45 minutes

- Explain the following terms in the text:
 - entrepreneur
 - tertiary sector
 - start-up finance
 - capital equipment. [8]
- Outline the factors of production needed to set up the business providing CVs to school leavers. [5]
- Using the gym instructor's business as an example, list the business functions involved in this business. [5]
- Explain the reasons why most of the would-be entrepreneurs were choosing to set up businesses in the tertiary sector. [7]

1 BUSINESS ORGANISATION AND ENVIRONMENT

02 Types of organisation

This chapter covers syllabus section 1.2

On completing this chapter you should be able to:

- distinguish between organisations in the private sector and public sector, applying these distinctions to your own country
 - explain reasons for starting a business, how to identify a market opportunity and the problems faced by business start-ups
 - distinguish between different types of profit-based organisations: sole traders, partnerships and companies
 - evaluate the most appropriate form of legal organisation for different businesses
 - compare and contrast the objectives of non-profit and non-governmental organisations and analyse the impact of their actions
- H**
- explain the nature of public-private partnerships, analysing the costs and benefits of co-operation between the public and private sectors.

SETTING THE SCENE

Dulip's business is a success

Dulip's business had been operating successfully for two years when he decided to expand it by opening his own furniture making factory. He wanted his business to grow so that he could bring his two sons into the venture.

Dulip realised that he would need more capital to build a furniture making factory. Although his business was profitable it was not making enough of a surplus to pay for the extra costs involved. 'Why don't you ask one of your friends to invest in your business as a partner?' suggested Maria, his wife. 'This would mean that you would not have to borrow so much.'

Dulip replied: 'I could do this and also ask them to help me manage the business. I am not sure that I could carry all of the management responsibilities. I might make my business a legally recognised organisation – a company – because this would be easier to leave to our sons and offers some protection for our savings.'

Forestry businesses in Dulip's country have been criticised by environmental pressure groups for cutting down too many trees. Dulip has responded to this pressure by planting more trees for each one his business cuts down.

Points to think about:

- Do you think it is a good idea for this business, currently only producing timber, to make and sell furniture? Explain your answer.
- Would you advise Dulip to involve one of his friends in the business as a partner? Explain your answer.
- What benefits does Dulip seem to think a 'company' will offer him?
- Why do some businesses change their decisions in response to pressure from environmental and other groups?



1 BUSINESS ORGANISATION AND ENVIRONMENT

Introduction

The first chapter looked at the classification of business into different economic sectors. This chapter further classifies business activity into:

- the private and public sectors
- profit-based and non-profit-based organisations.

Profit-based businesses in the private sector can take different legal forms and the advantages and disadvantages of these are very important. The growing importance of non-profit-based and non-governmental organisations is also analysed in this chapter.

Public and private sector organisations

Industry may be classified by public or private sector and by type of legal organisation. These two types of classification are interlinked as some types of legal structure are only found in the private sector.

The relative importance of the private sector compared to the public sector is not the same in all mixed economies. Those economies that are closest to free-market systems have very small public sectors. Those countries with central planning command economies will have very few businesses in the private sector.

KEY TERMS

private sector comprises businesses owned and controlled by individuals or groups of individuals

public sector comprises organisations accountable to and controlled by central or local government (the state)

mixed economy economic resources are owned and controlled by both private and public sectors

free-market economy economic resources are owned largely by the private sector with very little state intervention

command economy economic resources are owned, planned and controlled by the state

LINKS BETWEEN SECTORS

In most mixed economies, certain important goods and services are provided by state-run organisations – they are in the public sector. It is argued that they are too significant to be left to private sector businesses. They include health and education services, defence and law and order (police force). In some countries, important ‘strategic’ industries are also state owned and controlled, such as energy, telecommunications and public transport. These public sector organisations therefore provide essential goods and services for individual citizens and organisations in the private sector, and they often have objectives other than profit; for example:

- ensuring supplies of essential goods and services – perhaps free of charge to the user, e.g. health and education services in some countries
- preventing private monopolies – single firms that dominate an industry – from controlling supply
- maintaining employment
- maintaining environmental standards.

In recent years, there has been a trend towards selling some public sector organisations to the private sector – privatisation – and this means that they put profit making as one of their main objectives.

KEY TERM

privatisation the sale of public sector organisations to the private sector

Starting a business

ROLE OF THE ENTREPRENEUR

KEY TERM

entrepreneur someone who takes the financial risk of starting and managing a new venture

New business ventures started by entrepreneurs can be based on a totally new product or customer service idea or a new way of offering a service. People who set up their own new business show skills of ‘entrepreneurship’. They have:

- had an idea for a new business
- invested some of their own savings and capital
- accepted the responsibility of managing the business
- accepted the possible risks of failure.

The personal qualities and skills needed to make a success of a new business venture are described below.

Innovative

The entrepreneur may not be a ‘product inventor’, but they must be able to carve a new niche in the market, attract consumers in innovative ways and present their business as being ‘different’. This requires original ideas and an ability to do things innovatively.

Commitment and self-motivation

It is never an easy option to set up and run your own business. It is hard work and may take up many hours of each day. A willingness to work hard, a keen ambition to succeed, energy and focus are all essential qualities of a successful entrepreneur.

Multi-skilled

An entrepreneur will have to make the product or provide the service, promote it, sell it and count the money. These

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different business tasks require a person with many different qualities such as being keen to learn technical skills, an ability to get on with people and being good at handling money and keeping accounting records.

Leadership skills

An entrepreneur has to lead by example and must have a personality that encourages people in the business to follow them and be motivated by them.

Belief in oneself

Many business start-ups fail, yet this would not discourage a true entrepreneur who would have such self-belief in their abilities and business idea that they would bounce back from any setbacks.

Risk taker

Entrepreneurs must be willing to take risks in order to see results. Often the risk they take involves investing their own savings in a new business.

WHY START A BUSINESS?

Reasons for starting a new business include some or all of the following:

- Losing a job encourages many people to set up in business by themselves, either providing their former employer's product or another product, perhaps based on an interest or skill they have.
- Desire for independence – some people do not like the idea of being told what to do! By creating their own

business, they have work flexibility and control over their working lives.

- By talking to friends or family, it might become clear that a business opportunity exists that an entrepreneur could take advantage of.
- A wish to make more money than in the current job – many people setting up their own business believe that they will earn a higher income working for themselves.

START-UP BUSINESSES

New business start-ups can be found in nearly all industries. However, there are some industries and sectors of industry where there is a much greater likelihood of new entrepreneurs becoming established. These include:

- primary sector – fishing, market gardening (producing cash crops to sell at local markets)
- secondary sector – jewellery making, dress making, craft manufacture, e.g. batik cloth, building trades
- tertiary/service sector – hairdressing, car repairs, cafés and restaurants, child minding.

It would be unusual for entrepreneurs to successfully establish themselves in, say, the steel making industry or car manufacturing because of the vast amount of capital equipment and financial investment that would be required.

ACTIVITY 2.1

Read the case study below and then answer the questions that follow.

Bangalore Enterprise Blossoms

Rama Karaturi had the idea for his rose-growing business when he searched the city of Bangalore, without success, for a bouquet of roses for his wife's birthday. The city was a rose-free zone, so he decided to start growing them himself. He had wanted to take decisions for himself for some time and he also wanted to earn much more than his current salary. In 1996, he opened two greenhouses growing just roses. He used his own savings so took a considerable risk, but his confidence in the growth of 'flower giving' at times of major festivals encouraged other investors too. He sold the flowers in India, but his business also became one of the first in India to start exporting flowers on a large scale. Rama worked long hours to make his business a success. The business, called

Katuri Networks, has grown at a tremendous rate, helped by Rama's all-round business skills. He recently bought out a large rose grower in Kenya and his business is now the world's largest cultivator of roses – and Rama achieved this in a little over ten years.

Source: business.timesonline.co.uk (adapted)

16 marks, 28 minutes

- 1 Rama is an example of a 'business entrepreneur'. Explain what is meant by this term. [4]
- 2 Outline **two** reasons why Rama started his own business. [6]
- 3 Explain any **two** problems Rama's business might have experienced during the set-up stage. [6]