

# BUSINESS ORGANISATION AND ENVIRONMENT

## Unit 1

# 1.1

## Introduction to business management

### On completing this chapter you should be able to:

#### Analyse and apply:

- The role of business (AO2)
- The main business functions and their roles (AO2)
- Primary, secondary, tertiary and quaternary sectors (AO2)

- The nature of business activity (AO2)
- Reasons for starting up a business (AO2)
- Common steps in starting a business (AO2)
- Problems that a new business or enterprise faces (AO2)

#### Evaluate:

- The role of entrepreneurship and intrapreneurship in overall business activity (AO3)

### Setting the scene

#### ENTERPRISE PAYS OFF

Sean Walsh knew that his retail job was at risk during the economic problems of 2009. He wanted to start his own business to give his family more security. Sean is a keen jet skier and power boater but he cannot afford to own these expensive leisure products. When he tried to hire a jet ski at a large lake in the USA he was surprised by the price – \$400 a day – and the refusal of the renting company to offer insurance. Sean did not want to take any uninsured risks – he had a young family to think about – so he decided against renting. On the way home he noticed a large number of boats and jet skis lying idle in drives and parking lots and the idea occurred to him that these could be rented out to people who loved the sport but could not afford a boat. He did some market research and discovered what he considered to be a profitable gap in the market. He set up an online agency putting boat and jet ski owners in touch with people who wanted to rent – taking 25% commission when a rental was agreed. He also arranged insurance for both the renter and the boat owner. That was six years ago – he has since set up his own boatyard buying and selling second-hand power boats and jet skis, paid for from profits of the online rental agency.



### Points to consider

- Why do you think Sean decided to own and run his own business?
- What resources (or inputs) does Sean need to run his business successfully?
- What problems do you think Sean experienced when starting up his business?

### Key concept link

New enterprises need to differentiate themselves from rivals, many of whom will be well established. One way of achieving this is by innovation – providing either a different type of product or a service which is different from those of competitors or which is delivered in a distinct way.

## Introduction – 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 to enjoy a much higher standard of living than would be possible if we remained entirely self-sufficient.

**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.

## The role of businesses

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**.

**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’?

These are the human, physical and financial resources needed by business to produce goods or services. They are also known as factors of production. 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 coordinating 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 1.1.1 shows the wide range of these needs.

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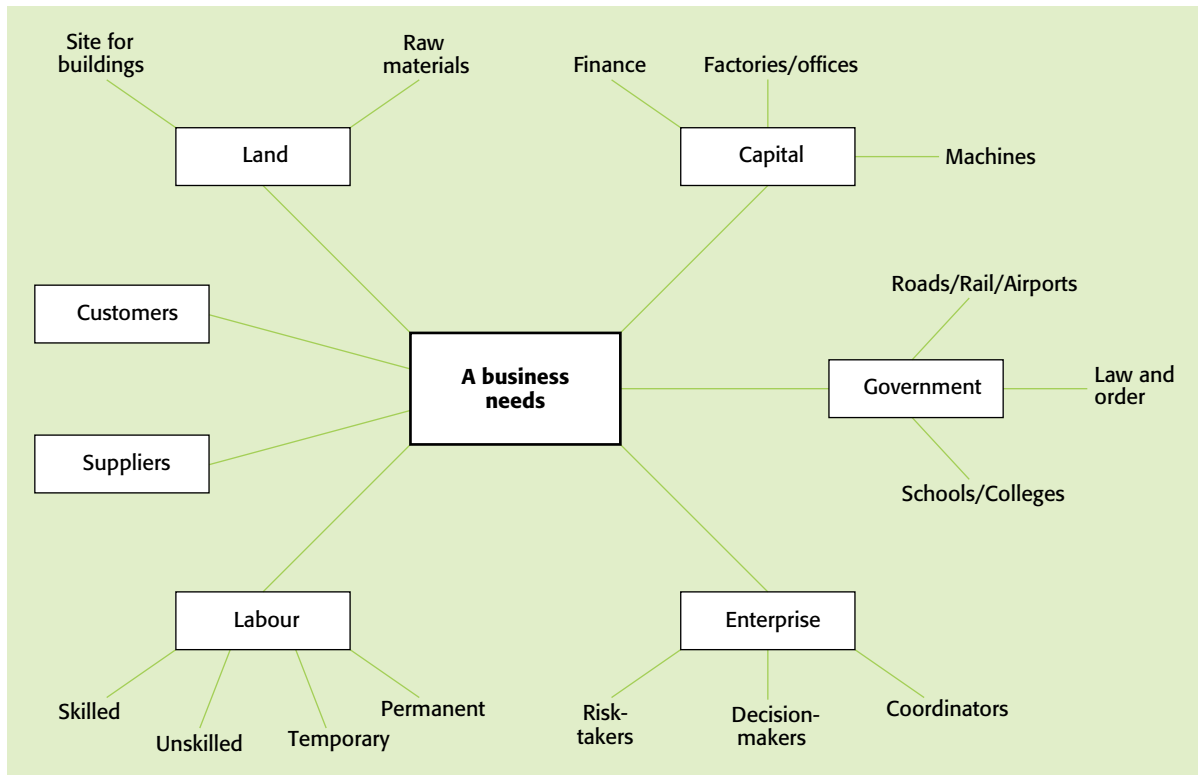


Figure 1.1.1 What businesses need

## 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.

### Human resource management

Human resource (HR) management identifies the workforce needs of the business, recruits, selects and trains appropriate employees and provides motivational systems to help retain workers and encourage them to work productively. It also draws up contracts of employment and covers the redundancy or redeployment of employees if these become necessary. The aim of this business function is to manage human resources to help the business achieve its overall objectives.

### Finance and accounts

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.

### 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

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Primary production – dairy cattle in France



Secondary production – clothing factory in India



Tertiary sector – the breathtaking Burj Al Arab hotel in Dubai

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.

### 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. This function is important in service industries as well as traditional manufacturing. In service industries, operations management will have the objective of ensuring that the processes for the delivery of the service are well tested, consistent and understood by all employees.

### Interrelationship of functions

It should not be assumed that all business decisions taken within these departments are separate and unconnected to 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, cooperation and close interrelationships between functions are essential before major decisions are taken. For example, the decision by BMW to develop and launch its first electric-powered sports car – the i8 – 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? Will quality of the vehicle be up to normal BMW standards?

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### ACTIVITY 1.1.1

Identify which business function is most likely to undertake the following roles:

Role	Function
Setting prices of new products	
Recruiting a new production manager	
Allocating resources to purchase capital equipment	
Deciding on the appropriate levels of stocks for raw materials	
Finding out if consumers prefer one product design to another	
Determining the level and number of employees the business needs for future operations	

**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

**quaternary sector business activity:** is focused on information technology (IT) businesses and information service providers such as research and development, business consulting and information gathering

## Economic sectors

All production can be classified into four broad types of business activity, or economic sectors. These categories are the three stages involved in turning natural resources, such as oil and timber, into the finished goods and services demanded by consumers plus the 'knowledge-based' support services that businesses require. The four sectors are **primary**, **secondary**, **tertiary** and **quaternary**.

National economic data often makes no distinction between tertiary and quaternary sectors. 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 1.1.1 shows the different economic structures of three countries.

Country	Primary	Secondary	Tertiary
United Kingdom	2	17	81
China	42	26	32
Ghana	54	20	26

**Table 1.1.1** Employment data 2013 – as percentage of total employment

### Changes in economic structure – sectoral change

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

1. 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.

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- 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 countryside 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.

In more economically 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 for by secondary industry has fallen by 13% to 20% in 25 years. In South Africa, the relative importance of the secondary manufacturing sector fell from 20% to 17% between 1993 and 2012. The reasons for and possible impact of these changes 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 1.1.1 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 – don't forget that these are often available free online. 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?

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### ACTIVITY 1.1.2

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

- 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.
- Research **five** businesses that operate in your country and identify which sector of industry they mainly operate in and what their main activities are.

### ACTIVITY 1.1.3

#### BP OPERATES IN THREE ECONOMIC SECTORS

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

#### BP announces another huge oil find

BP has just released details of its third major oil reserve discovery in the US Gulf of Mexico. This will enhance BP's position as one of the largest crude oil suppliers in the USA.

#### BP Castillon refinery

BP's Castillon refinery is the only oil refinery in this region of Spain. It has the capacity to convert 110,000 barrels of crude oil each day into a range

of products used by road vehicles, the aviation industry, chemical manufacturers and the plastic industry.

#### BP now operates 800 petrol stations in China

BP is a familiar petrol and diesel brand to car and truck drivers in China. The company co-owns over 800 petrol station sites – mainly with PetroChina. BP has a leading position in the petrol retail market.

**10 marks, 20 minutes**

- Define the term 'economic sector'. [2]
- Using examples from these articles, explain the statement that 'BP operates in all economic sectors'. [4]
- Explain why a decision by BP to open new petrol stations in China will involve effective cooperation between all four business functions. [4]

## Starting a 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 a 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.

## Role of the entrepreneur

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'. People who are given responsibility to develop and market a product within a large corporation show skills of 'intrapreneurship'.

Entrepreneurs 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.

**Intrapreneurs** do not risk their own capital and the consequences of failure are accepted by the organisation that they work for. They can drive forward a new product idea and help make the organisation that they work for more innovative and able to cope with change.

### THEORY OF KNOWLEDGE

'The Entrepreneurial Instinct profoundly reveals that exceptional success has more to do with thoughtful risk-taking and agility than school pedigree, I.Q. and even decades of experience. Fear keeps us small, but following your instinct with stamina and passion can lead to greatness.'

Ajay Banga, President and CEO, MasterCard Worldwide

What does Ajay Banga's statement tell us about the importance of sense perception when making business decisions?

The personal qualities and skills needed for entrepreneurs or intrapreneurs 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 different business tasks require a person with many different

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

**intrapreneur:** someone within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through using 'entrepreneurial talents' such as risk-taking and innovation

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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. Intrapreneurs may also have to take risks but the financial consequences – other than the risk of losing their jobs – are borne by the organisation.

## LEARNER PROFILE

### Risk-takers

According to Bloomberg, eight out of ten entrepreneurs who start businesses fail within the first 18 months. Predicting the success of a business is an incredibly difficult thing to do. People who start businesses and then see them fail can lose large sums of money and suffer what can be the significant emotional pain associated with business failure.

To what extent do new entrepreneurs have to be risk-takers?

## 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, dressmaking, craft manufacture, e.g. batik cloth, building trades
- tertiary/service sector – hairdressing, car repairs, cafés and restaurants, childminding
- quaternary sector – IT support, website design, consultancy.

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.

## Impact of enterprise (and intrapreneurship) on business activity

All governments around the world are following policies that aim to encourage more people to become entrepreneurs. What are the claimed benefits to the economy and business activity of enterprise?