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# Business Organisation and Environment

## Unit 1

# Introduction to business management

## 1.1

### What you should know by the end of this chapter:

- How businesses combine human, physical and financial resources to create goods and services (AO2)
- The role of the business functions: human resources, finance and accounts, marketing and operations (AO2)
- The nature of the primary, secondary, tertiary and quaternary sectors of the economy (AO2)
- The impact of changes in the primary, secondary, tertiary and quaternary sectors on business activity (AO2)
- The role of entrepreneurship and intrapreneurship in overall business activity (AO3)
- Reasons why entrepreneurs start up a business or an enterprise (AO2)
- Problems that a new business or enterprise may face (AO2)
- The elements of a business plan (AO2).

### Chapter illustrative example

A business that runs a chain of pizza restaurants

## Combining resources to create goods and services

### Human resources

#### Key term

**Businesses** are organisations that bring together resources to produce goods and services that are sold to customers.

Human resources are the people aspect of a **business**. This is the:

- direct labour that is involved in producing the good or service, such as the people who serve in the pizza restaurant in the example
- indirect labour that supports the running of the organisation like the pizza business's accountants
- managers that direct the organisation, such as the finance director of the pizza business who oversees its use of financial resources.

### Financial resources

Financial resources are the funds a business has to facilitate its organisation. Finance involves the:

- day-to-day funds used by a business to pay wages and buy raw materials
- long-term finance needed for investment in plant and machinery, such as opening a new pizza restaurant outlet
- recording of business profits and asset value.

### Physical resources

Physical resources are the capital of the business in the form of:

- buildings, such the outlets in the pizza business example

## 1.1 Introduction to business management

- equipment, such as the cookers used by the pizza business
- fixtures and fittings in the pizza restaurant outlets.

## The role of the main business functions

Business functions are the different aspects of business operations and they can be put into four different areas:

### Human resources

Human resource management (HRM) is the way in which a business manages the people in its organisation. This involves things such as how a business's employees are recruited, trained, motivated and promoted.

### Finance

The finance department in an organisation has to make sure the business has the funds to operate on a day-to-day basis as well as having the finance to invest in its future operations. This area of the organisation is also responsible for producing the business accounts and for budgeting.

### Marketing

The marketing department of an organisation is responsible for discovering, predicting and satisfying the needs and desires of consumers in a profitable way. It involves managing market research, product development, pricing, distribution and promotion.

### Operations

Operations management is the way that organisations manage physical resources. Businesses want to manage their stock, equipment, machinery and buildings in the most efficient way they can.

# 1.1

## CASE STUDY

### Apple

Successful businesses manage their resources to produce goods and services that provide the income and profits allowing it to function. Apple exists as one of the biggest private organisations in the world, valued at \$700 billion. It achieved a profit of \$53 billion in 2015 because it manages its resources successfully to produce goods and services that so many people want to buy.

### Progress questions

- 1 Define the term 'business'. [2 marks]
- 2 Outline two resources involved in Apple's production of goods and services. [4 marks]
- 3 Describe two of Apple's business functions. [4 marks]

## Different business sectors

### Primary

Businesses that operate in the primary sector of the economy are involved in agriculture, forestry, fishing and mining. The goods produced by primary sector businesses are sold to manufacturing firms in the secondary sector to produce goods sold to consumers. An example of a firm in the primary sector is a mining company.

### Secondary

The secondary sector of the economy is made up of manufacturing organisations that make goods to sell to other businesses and final consumers. Secondary sector organisations range from car manufacturers to makers of computer software.

### Tertiary

Firms in the tertiary sector provide services to consumers and other businesses. This involves organisations such as restaurants, retailers, insurance companies and banks. The pizza business example is part of the tertiary sector.

## Quaternary

Organisations involved in the quaternary sector of the economy are businesses focused on information technology. A social media business, for example, is part of the quaternary sector.

## Impact of sectoral change on business activity

Over time, the balance of industrial structure in an economy changes as that economy develops. Economic development generally means that there is shift in the balance of business operations from the primary sector to the secondary sector and from the secondary sector to the service sector.

The success of the example fast food restaurant in the service sector is one such business that might flourish as sectoral change takes place.

## Role of entrepreneurship and intrapreneurship in business activity

### Entrepreneurship

#### Key term

**An entrepreneur** is an individual that sees a business opportunity in the form of consumer want and then brings together human, physical and financial resources to produce a product to satisfy that want.

The founder of the pizza chain restaurant example is an **entrepreneur**.

### Intrapreneurship

#### Key term

**An intrapreneur** is someone who works within a business in an entrepreneurial way to develop a firm's products to attract new consumers.

## 1.1 Introduction to business management

### CASE STUDY

#### Gmail

Google is a US-based multinational technology business that specialises in internet-related services including its search engine, cloud computing and software. The business was founded by entrepreneurs Larry Page and Sergey Brin in 1996. Gmail is the free email facility provided by Google. It was developed by Paul Buchheit in 2001 when he was working for Google and is an example of successful intrapreneurship.

#### Progress questions

- 1 Define the term 'intrapreneur'. [2 marks]
- 2 Describe the business sector Google operates in. [2 marks]
- 3 Explain two roles of the entrepreneurs who started Google. [4 marks]

#### Exam tip

For 'definition' command term questions, give a precise meaning of the term.

## Reasons for starting up a business or an enterprise

These are some of the reasons entrepreneurs might start a business:

- **Redundancy** – People frequently start businesses after losing a job and see running a start-up business as an opportunity for employment.
- **Independence** – New businesses are often started by individuals who want to control their own destiny and not be constrained by an employer.
- **Business opportunity** – Entrepreneurs often spot a market that is potentially profitable and then start a business to reach that market.

- **Greater income** – Starting your own business is often a way to earn more money than would be possible working for a company.

The pizza business example was started by two people who worked for another restaurant chain and wanted to be independent.

## Problems that a new business or enterprise may face

Any new business will face challenges when it enters a market. Some problems faced may include:

- **Competition** – Established businesses in a market will work hard to keep their existing customers and competitors will always try to attract any new buyers in a market.
- **Access to finance** – Because so many new businesses fail, banks and other lenders are reluctant to lend to new firms. This can mean they struggle to get finance for investment in capital and funds for working capital in order to support the day-to-day running of the business such as paying wages and suppliers.
- **Regulation** – Markets always have rules and regulations that new firms have to follow when they start up. The pizza business, for example, had to deal with licences, product standards, health and safety and employment law.
- **Information** – New businesses often lack essential data and records when they enter a market. Information systems have to be set up to generate information, for example, about consumers in the market, finance data for tax and industry regulations.
- **Management experience** – Starting a new business is often very difficult and requires considerable management skills. The process of setting up and then guiding a firm through the early part of its life can be a very complex one.

# 1.1

- **Changing markets** – The business environment is constantly changing: new competitors, tastes of consumers, regulations and the macroeconomic environment can move against a new enterprise.

## CASE STUDY

### CliniCloud

CliniCloud is an Australian health technology business that was started by physicians Hon Weng Chong and Andrew Lin. The firm's product is technology-based medical kits to manage and monitor people's health from home. Putting together a business plan was a key part of raising the \$5 million needed to start their business.

### Progress questions

- 1 Outline two reasons why the owners of CliniCloud might have started the business. [4 marks]
- 2 Analyse two problems the owners of CliniCloud might have faced when starting their business. [6 marks]

## The elements of a business plan

**Business plans** are a very important planning tool for the successful management of a new business as well as providing important information for different stakeholders. An effective business plan was, for example, a crucial part of the pizza business securing a bank loan.

### Key term

**A business plan** is a formal document that describes the business, sets out its objectives and strategy, identifies its market and provides its financial forecasts.

## Elements

- **Business description** – Sets out the nature of the business in terms of size, product, target market and mission.

- **Competitive analysis** – Looks at the competing businesses in the market and alternative products available.
- **Business objectives** – These are the overall mission of the business and the strategic goals the firm needs to achieve to reach its mission.
- **Marketing strategy** – This sets out the market research the business has done and ways the marketing mix is going to be successfully set to sell the product to its target consumers.
- **Design and development plan** – This part of the business plan gives specific information on the processes involved in designing and developing the product.
- **Operations and management plan** – This is about how the product is going to be produced or manufactured and delivered or provided to the consumer.
- **Financial forecasts** – This section is critical for funding a new business. This involves setting out funds needed to cover both set-up and operating costs as well as forecasting the funds generated through selling the product.

## Exam practice questions

### Paper 1 question (HL and SL)

#### Fine Olive Company

The Fine Olive Company is a Greek olive-grower that produces and markets its own high-quality olives and olive oil. The business was started by Mimis Manolas in 2009 after he was made redundant from his job working as a civil servant. He was able to buy the small farm and the equipment required from money loaned to him by his parents. He also needed to obtain a bank loan, which required a detailed business plan.

- a Define the following terms:
  - i Business plan [2 marks]
  - ii Entrepreneur [2 marks]

## 1.1 Introduction to business management

- b** Analyse two difficulties Mimis Manolas might have encountered when he started the Fine Olive Company. [6 marks]

[Total 10 marks]

### Paper 2 question (HL and SL)

#### A business opportunity in Rome

Luca Abatangelo works for a national chain of estate agents in Rome. He is looking to open his own estate agency selling and renting residential property in the city.

The property market in Rome is beginning to grow after a period of stagnation. There is strong demand for properties to buy and rent. This has led to an increase in new businesses entering the market particularly at the top (luxury) end of the market.

There is a considerable amount of regulation in the Italian property market and this is something Luca will

have to deal with. However, this is also a market where being well known is a distinct advantage and this will work to Luca's benefit.

- a** Identify two business functions that might be part of Luca's new estate agency business. [2 marks]
- b** Explain two reasons why Luca might want to start his own estate agency business. [4 marks]
- c** Explain two problems Luca might encounter as he enters Rome's property market. [4 marks]
- d** Discuss the usefulness to Luca of producing a business plan when starting his new estate agency business. [10 marks]

[Total 20 marks]

#### Exam tip

The 'discuss' command term means offering a considered and balanced review that includes a range of arguments of the factors associated with producing a business plan.

# Types of organisations

## 1.2

### What you should know by the end of this chapter:

- Distinction between the private and the public sectors (AO2)
- Main features of the following types of for-profit (commercial) organisations: sole traders, partnerships, companies and corporations (AO3)
- Main features of the following types of not-for-profit social enterprises: cooperatives, microfinance providers, public–private partnerships (PPPs) (AO3)
- Main features of the following types of non-profit social enterprises: non-governmental organisations (NGOs), charities (AO3).

### Chapter illustrative example

A state funded and managed hospital



## The private and the public sectors

### The private sector

#### Key term

**The private sector** is made of businesses and organisations owned and controlled by individuals or groups of individuals that are not under state control.

The private sector is made up of:

- **For-profit (commercial) organisations** that range from the largest multinational companies down to the smallest sole traders. The profit the business makes goes to its owners or shareholders.
- **Not-for-profit organisations** use their surplus revenue over cost to finance their objectives or mission. Examples might be housing charities, environmental organisations and sporting organisations.

### The public sector

#### Key term

**The public sector** is made up of organisations that are primarily financed and controlled by a country's government.

The public sector is made up of:

- **National organisations** where central government appoints managers and directors to run the organisation. They are often funded through government tax revenue and from revenue generated by the organisation. The hospital example is part of the public sector.
- **Local organisations** often controlled and funded by regional governments. These tend to be locally-based services such as waste disposal, schools and leisure centres. The hospital example is a locally-based organisation.

### CASE STUDY

#### British Airways

British Airways was formed by the UK government in 1974 as a public sector organisation owned and managed by the state. Any surplus revenue over cost that BA made was either returned to the UK government or reinvested in the airline itself. In 1987, the UK government privatised BA and it became a private sector business. Shares in BA were sold by the government to private individuals.

#### Progress questions

- 1 Define the term 'private sector business'. [2 marks]
- 2 Outline two characteristics of public sector businesses. [4 marks]
- 3 Analyse two benefits to British Airways of becoming a private sector business. [6 marks]

#### Exam tip

This 'outline' command term means giving a brief account or summary of the characteristics of public sector businesses.

## Features of different for-profit organisations

### Sole traders

#### Key term

**A sole trader** is an organisation owned and controlled by a single person.

#### Sole traders' strengths:

- small flexible organisations that can quickly react to change

# 1.2

- single owner means quick decision-making
- owner keeps and has access to all the profits and funds generated if the business is partly or wholly sold.

### Sole traders' weaknesses:

- limited access to finance
- do not have the benefit of expertise from partners or joint owners
- as small businesses they miss out on economies of scale.

## Partnerships

### Key term

**A partnership** is a business where two or more individuals jointly own and take responsibility for the enterprise.

Partners share the decision-making process and the profits made by the organisation.

### Partnerships' strengths:

- organisations are often small enough for flexible decision-making
- partners bring different expertise to the organisation to help decision-making
- finance from partners increases the funds available to the organisation.

### Partnerships' weaknesses:

- having more people involved in strategy can slow down the decision-making process
- there can be conflicts between partners
- profits have to be shared between partners.

## Private companies

### Key term

**A private company** is a business that has shareholders who are invited to buy shares in the business by the existing owners.

The shares of a private company are not traded on a stock market. They have limited liability where shareholders are not personally required to pay any outstanding debts of the company if it goes bankrupt.

### Private company strengths:

- access to additional finance through shareholders
- as the business increases in size, it gains economies of scale
- wide access to expertise through more shareholders.

### Private company weaknesses:

- as more shareholders join the business, the control of existing shareholders is reduced
- with more shareholders, there is more opportunity for conflict between them
- profits need to be shared out between more shareholders.

## Public limited companies

### Key term

**Public limited companies (PLCs)** are private sector businesses that sell their shares on a stock exchange to private investors.

Anyone is able to buy shares in a **Public limited company** and the shares are traded freely on a stock exchange.

### PLC strengths:

- selling shares on a stock exchange can generate large amounts of funds for the business