Chapter 1-What is a business?

What you should know- You should be able to:

- The nature of business
- Define the following terms:
  - Primary sector
  - Secondary sector
  - Tertiary sector
  - Quaternary sector
- Entrepreneurship
- Explain the opportunities and challenges of starting a new business

The Nature of Business

A **business** can be defined as a decision-making organization involved in the process of using inputs to produce goods and/or provide services. Businesses exist to produce goods and services to satisfy the needs and wants of their customers (individuals, other businesses and/or governments), usually in return for a profit. There may be additional or alternative objectives, such as survival, increasing their market share, being the market leader, or being a socially responsible business.

Goods are physical products, e.g., food, clothes, furniture, cars and smartphones.

CONSUMER GOODS: goods that are bought and used in satisfaction of human wants and are not utilized in any further production. It includes (i) consumer durable goods * that last a long time * can be used repeatedly. Example: clothes, home furniture or electronic gadgets. (ii) non-durable goods* that needs to be consumed shortly * can't be reused. examples: beverages, fresh food or medicines.

CAPITAL GOODS: goods that are bought by businesses to produce other goods. Example building, machinery, tools or equipment.

Services are intangible products, e.g., haircuts, tourism, public transport, banking, legal advice, financial advice, insurance education, and healthcare.

To produce goods and services, businesses need to combine human, physical and financial resources in an effective way. Economists call these resources **factors of production**, which are comprised of:

Land

These are natural resources needed to produce goods and services. Examples include water, timber, sand, minerals, metal ores, plants and animals. Hence, these are sometimes referred to as physical resources.

Labour

This refers to human effort used to produce goods and services. Hence, this is often referred to as human resources.

Capital

This refers to non-natural (or manufactured) resources used in the production process. Examples include tools, machinery, motor vehicles, physical premises, and infrastructure. As these are all funded by money, capital resources are sometimes referred to as financial resources.

Entrepreneurship

This refers to the knowledge, skills and experiences of individuals who have the capability to manage the overall production process. Entrepreneurs have the ability and willingness to take risks in order to produce goods and provide services to customers, profitably.

The main functions of Business

In order to provide goods and services, businesses carry out a number of functions. These independent functional areas are:

- Human resources
- finance and accounts,
- Marketing
- Operations management.

They must work together to achieve organization’s goals.

Human Resources

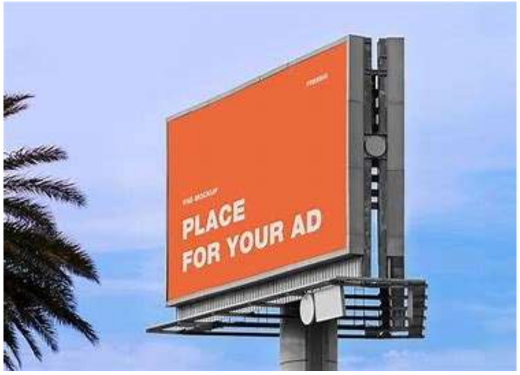
Human resources (HR) is the function that handles all aspects relate to the workforce.
It involves all aspects of business operations related to staff (personnel) within an organization.
Examples include the: recruitment, induction, training, development, appraisal, promotion, remunerating (rewarding), Redundancies (work is no longer available), dismissal of staff (terminating) and fair treatment of employees.

The **HR Department** must also comply with legal aspects of the external business environment . In particular, it must observe different labour laws in all the countries it operates in. Examples include laws about: minimum wages, working hours, gender equality, equal opportunities, and anti-discrimination

Finance and Accounts

The **finance and accounts** function of an organization refers to the responsibility for ensuring that the business has sufficient funds in order to conduct its daily operations. Essentially, the finance and accounts department is responsible for managing the organization's money and maintaining accurate accounts (financial records) of the firm's funds.

Marketing



Marketing is about identifying and satisfying the needs and wants of customers. It is ultimately in charge of ensuring that the firm's product sell. This is done through series of activities such as market research, test marketing, advertising and branding. It also includes selling the right product, at the right price, at the right time, to the right customers and Promotion to inform and persuade customers about buying the products

Operations

It is responsible for the process of converting raw material into finished goods, ready for sale and delivery to customers. It includes Producing the correct quantity to be delivered at the lowest cost possible given the standards of quality expected by customers

large organisations can easily organise all these functions through various departments as Head of marketing, Chief financial officer. Whereas in small organisations, all four activities are carried out by an entrepreneur, sole trader or the owner.

All four of these functions of a business <u>are interdependent</u>, i.e. depend and are reliant upon one another. For example,

THE MARKETING DEPARTMENT, AFTER DETERMINING THAT CHANGES SHOULD BE MADE IN A PRODUCT, MUST THEN CONSULT WITH-

- Operations to determine whether and at what cost changes in production can be made
- Finance and accounts to determine how much finance will be required to implement the changes, and
- HR to determine if new or differently skilled workers will be required and how they can be recruited or trained.

Primary, Secondary, Tertiary and Quaternary Sectors

The Primary Sector

The **primary sector** refers to business activity involved with the extraction of natural resources. For example, metal ores and coal have to be mined, oil and natural gas have to be drilled from the ground, rubber needs to be extracted from trees, foodstuffs need to be farmed, livestock need to be managed by farmers, and fish need to be trawled.

Examples of primary sector output include:

- Agricultural farming (crops)
- Animal husbandry (animals and livestock)
- Extraction of oil and gas
- Fishing
- Forestry and logging
- Hunting
- Mining
- Quarrying

Primary sector output is the predominant sector in less economically developed countries (LEDCs) or low-income economies and contributes for a large percentage of output (GDP) and employment.

The **added value is the process of producing a particular good or service that is worth**

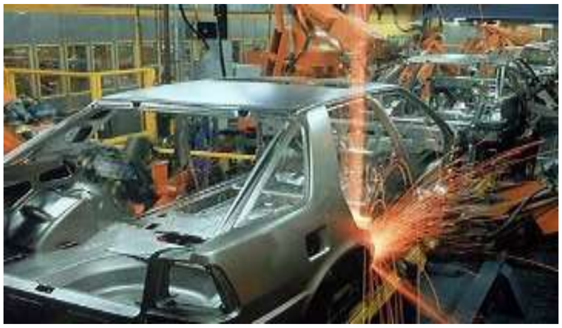
more than the cost of the resources used to produce it.) of primary sector output is relatively low. For example, raw materials such used to manufacture a smartphone cost far less than the final product sold to consumers. Hence, workers in the primary sector are typically paid less than those in the secondary or tertiary sector

Secondary Sector

Secondary sector refers to manufacturing and processing, where raw materials are converted into products for sale

Examples of secondary sector production include:

- Car manufacturing
- Carpentry
- Construction
- Engineering
- Energy production
- Food processing
- Oil refining
- Road construction
- Steelworks
- Tailors and dress makers



Secondary sector output is the predominant sector in economically developing countries (or middle-income economies). It accounts for the majority of gross domestic product (GDP) and employment in these countries or states

Tertiary Sector

The **tertiary sector** refers business activity that involves providing services to customers, i.e., consumers and business clients. Tertiary sector output is the predominant sector in economically developed countries (or high-income economies). The tertiary sector of the economy accounts for the majority of gross domestic product (GDP) and employment in these countries.

Examples of tertiary sector business activities include:

- Advertising
- Banking
- Education
- Health care
- Insurance
- Legal services
- Real estate (commercial and residential property)
- Transportation
- Travel, hotels and tourism

The **added value** of tertiary sector output is very high. For example, households are generally willing to pay the high prices charged by a plumber to fix a leaking water pipe. This is because the plumber provides high added value services to the consumer by fixing the leak, something that the consumer has no expertise or time to complete.

Quaternary Sector

Quaternary Sector

The **quaternary sector** refers to business activity involving the creation or sharing of knowledge and information. Businesses operating in these knowledge-based industries deal with digital information communication technology, research and development (R&D), and other high-level services.

Examples of production activities in the quaternary sector include:

- Tertiary and higher education
- Information and communications technology (ICT)
- Management consultancy
- Management information systems (MIS)
- Market research firms
- Online educational providers, such as InThinking and Pamoja Education
- Research and development (R&D), e.g., biotechnology and pharmaceutical companies:
- Software and 'app' developers

The added value is extremely high in the quaternary sector. For example, each year, many students (or their parents) are willing to pay very high tuition fees charged by higher education establishments and universities.

Characteristics of Entrepreneur

Risk takers	Above all, entrepreneurs are willing to take on the risk of starting a new organization. They may have had to give up secure jobs and put up personal funds in order to get started.
Self-motivated	Starting up a new business takes discipline. Many entrepreneurs begin their companies alone. Working long hours without a boss and an existing structure requires a strong will and commitment to purpose.
Confident	All start-ups face obstacles that require confidence and optimism to overcome.
Innovative	Most businesses begin with an idea for a new good or service that will serve unmet demand in the marketplace. Even opening a new coffee shop requires developing an offering that is different from those already in the neighborhood.

Entrepreneurs are the owners of an organization who plan, organize and manage the other three factors of production. They are the risk takers who exploit business opportunities in return for profits. **Entrepreneurship** is the process of setting up a new business.

Challenges for starting up a new business

Lack of finance – Many new businesses lack the necessary finance to have sufficient liquidity to run the business on a daily basis (such as paying wages and utility bills). Financial challenges are a major problem for many start-up businesses. In some cases, the lack of sufficient working capital can lead to bankruptcies.

Even if entrepreneurs are able to borrow money, the funds may be insufficient or high interest charges might seriously affect the cash flow position of the firm.

Unestablished customer base – A major challenge facing a new business is building a broad and loyal customer base. The problem is intensified when there are established competitors that already operate in the market

Cash flow problems- Financing working capital (the money available for daily running of a business) is a major challenge for many business start-ups. A business might have a lot of stock which cannot be converted into cash, customers might demand for a lengthy credit period of buy now and pay later, so the business will not receive the cash payment until the credit period is over. However, during this time business still needs to pay for its ongoing costs such as rent, utility bills, taxes and interest payment on bank loans.

Marketing problems- Another related challenge is that new businesses have limited marketing budgets available for promoting and advertising their products. No matter how good an idea might be or how competitively priced it is, customers will not buy it if they are not informed that it exists. For many products, the challenge is a lack of differentiation or not having a unique selling point, so they fail to gain any recognition in the market.

People management problems- New businesses may lack experience in hiring the right staff with all necessary skills. This can lead to poor levels of labour productivity and a need to retrain and rehire staff, all of which can be very expensive and time consuming.

Legalities- It is for business to comply with all necessary legislation, including business registration, insurance cover for building, consumer protection laws and rules about intellectual property such as copyrights, patents and trademarks. The legal requirement of setting up a new business can be time consuming and expensive.

Production problems – It can be challenging for business start-ups to accurately forecast the levels of demand so they are more likely to either over produce or under produce. Overproduction leads to stockpiling, wastage and increased costs. By contrast, underproduction leads to dissatisfied customers and loss of potential sales

High production costs- New businesses involves high production cost of purchasing capital equipment, rent, advertising and insurance.

Economies of scale- small firms do not achieve economies of scale as the average cost of production is high as there is no bulk purchase if raw material

Poor Location- Rental and leasing charges can be expensive for the new firms leading to high fixed cost and that is the main reason why small firms initially operate from their homes.

Lack of knowledge, skills, and experiences – Too often, new entrepreneurs do not have sufficient knowledge, skills or experience in the industry they are entering. For example, they may lack knowledge of their target market, competitors and market trends. They may also lack knowledge of the best suppliers, which can cause higher costs and distribution problems. Finally, inexperienced entrepreneurs may lack the experience to make effective strategic decisions. Ultimately, all of this results in the business making huge losses.

Opportunities for starting a business

There are many interrelated opportunities why people start their own businesses or an enterprise-

Earnings – Perhaps the key driving force for a person to start their own business is the ambition or motivation to earn profit for themselves. A firm earns profit by selling its products at a price that is higher than its production costs. The owner(s) get to keep the profit as a reward for risk-taking and their entrepreneurship talents.

Autonomy – Many people set up their own business to be their own boss, rather than working for someone else. Some people do not like to work for other people and prefer the autonomy that comes with being an entrepreneur. There is a great sense of satisfaction in being the "boss". The autonomy of being your own boss also speeds up decision-making.

Challenges – Some people are driven by personal challenges. They enjoy the satisfaction of achieving what they perceive to be greatness and striving for self-actualization. Being successful boosts self-esteem.

Passions/ Hobbies – Some people might want to pursue their passion or to turn their hobby into a business. Successful entrepreneurs have a passion for what they do and this made easier if the work is directly related to their interest.

Transfer and Inheritance – In many societies it is a cultural norm to pass on assets, including business to the next generation. Many self-employed entrepreneurs view their business as something that they can pass on (transference) to their children (inheritance) to give them a sense of security that might not be possible if they choose to work for someone else. Other more well-known examples of businesses owed wholly or largely by family members include: Mars (still

Unfilled market opportunities - Some entrepreneurs spot an unfilled gap in the market for a certain type of good or service, so start their own business. Many online entrepreneurs, for example, have recognized business opportunities in this way, such as Travis Kalanick and Garrett Camp who co-founded Uber in 2009

KEY TERMS

- **Adding value** is the process of producing a particular good or service that is worth more than the cost of the resources used to produce it.
- A **business** can be defined as a decision-making organization established to produce goods and/or provide services.
- **Consumers** are the people who use goods and services. They are not necessarily the customers though.
- **Customers** are the people or other businesses that purchase goods and services.
- **Factors of production** as the collective term for the resources needed to produce goods and services. Businesses combine human, physical and financial resources in an effective way to create goods and services to meet the needs and wants of consumers.
- **Goods** are physical products, e.g. food, clothes, furniture, cars, and smartphones
- **Services** are intangible products, e.g. haircuts, tourism, public transport, banking, insurance education, and healthcare.
- The **primary sector** refers to business activity involved with the extraction of natural resources.
- The **quaternary sector** refers to business activity involving the creation or sharing of knowledge and information.
- The **secondary sector** refers to business activity involved with the manufacturing or construction of finished products.
- The **tertiary sector** refers business activity that involves providing services to customers, i.e., consumers and business clients.