

Business Management

for the IB Diploma

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Introduction to business management

1

Conceptual understandings

- **Change** is essential for businesses to achieve their desired aims.
- **Creative** business planning can lead to organizational success.
- **Ethical** business behavior improves a business' image as well as customer loyalty.
- **Sustainable** business practices can enhance a business' existence.

1.1 What is a business?

Learning outcomes

At the end of this section, you will be able to:

- understand the nature of business
- distinguish between primary, secondary, tertiary and quaternary **sectors**
- analyze the challenges and opportunities for starting up a business.

Inquiry questions

- Factual:** What is business activity?
What are the functional areas of a business?
- Conceptual:** What is the role of innovation in promoting enterprise/ entrepreneurship activities?
Why do businesses fail? Analyze the challenges faced by new businesses.
- Debatable:** How does ethical behavior contribute to business sustainability?

The nature of business

From the moment you wake up until you go back to sleep, you are constantly in contact with different businesses. When your alarm goes off, you probably look at your phone and check whether you have any messages. You are already interacting with a business – your telephone provider. When you get your breakfast ready, you interact with the businesses that produced the cereal you eat, the milk you drink, or the power you use to warm up your breakfast in the microwave. This continues all day. Understanding how you interact with different businesses will allow you to understand how important business is and how it works.

Before we proceed, let's understand the difference between business as an activity and a business as an organization.

What is business?

Business is any activity that provides goods and services to consumers with the aim of making a profit.

What is a business?

A business is an entity or organization that produces goods and services. The organization adds value to resources to create products that meet the needs and wants of consumers.



Figure 1.1 A diagram showing the nature of business: identifying inputs, following business processes and creating outputs

Businesses are often successful because they identify a **need** or **want** in the market that is not already being exploited by other businesses.

Needs are human requirements that must be met for survival, and they are limited. Examples include food, warmth, shelter, clothing and healthcare.

Wants are human desires that are unlimited. They are not essential for survival, for example, entertainment, travel, gym memberships, etc.

Figure 1.1 shows the nature of business. The nature of a business refers to its legal structures, business objectives, industry, resources, business processes and products. Businesses transform inputs using different business processes to provide goods or services to fulfil the needs and wants of consumers.

For example, a bakery business produces and sells products such as bagels, buns, rolls, biscuits, breads, cookies, cakes, etc. The bakery offers the product to meet the needs and wants of households in its neighborhood. However, a business may find an innovative way of providing a product that is different to what current businesses are offering. A traditional bakery can grow its business and offer its products to a wider range of customers by selling online.

Resources

The resources used to produce goods and services are also called **inputs** and can be categorized into four major types:

- **Capital** refers to the manufactured goods needed to operate a business, such as machines, buildings, vehicles and equipment. Capital goods need to be distinguished from consumer goods. Capital goods are used in production, while consumer goods are sold to the public to meet their needs and wants.
- **Land** includes the raw materials and natural resources needed to produce goods and services.
- **Labor** is the effort/work done by people. The quality of the work depends on their skills, knowledge and experience.
- **Enterprise/entrepreneurship** involves making a profit by identifying an opportunity, starting a company, arranging business deals and taking risks, and efficiently using the other three inputs (capital, land and labor). Today's competitive business environment requires knowledge and learning. The businesses that succeed are those that learn fast, use knowledge efficiently and develop new insights.

The quality of products depends on the quality of inputs. Disruption in the availability of resources can affect the entire production process and can result in high costs and delays in the production of goods and services.



A bakery provides bread, which satisfies the basic need for food

TOK

What is the role of individuals in bringing about major changes in the theory and practice of business management? Discuss your ideas.

Products

Products are the output of a business activity. Products sold by businesses can be divided into two main categories:

- **Goods** are physical products.
- **Services** are intangible products. These are the tasks performed by labor.

A grocery store sells goods (bread, meat, pasta, oil, dairy, etc.) whereas other businesses provide services.

A medical clinic is a service business. Other service businesses include banks, taxi firms, law firms and airlines. Some businesses provide both goods and services. For example, Apple sells goods (e.g. iMac, iPhone, iPod, iPad) and provides services (e.g. AppleCare, Apple Pay, Apple Music).

Based on the type of product, a business can be a manufacturing organization or a service organization. A manufacturing organization produces goods whereas a service organization provide services. A business that provides goods and services is categorized as a manufacturing organization as well as a service organization.

Table 1.1 The differences between goods and services

Goods	Services
Goods are physical products	Services are not physical products
Businesses producing goods have lower customer contact	Businesses providing services have higher customer contact
Production of goods can require large facilities	Provision of services usually requires small facilities
Production of goods can be capital intensive	Provision of services can be labor intensive
Quality of goods produced can be easily measured	Quality of services provided is difficult to measure

Activity

Identify the resources (inputs), business processes and products (outputs) for the following businesses:

- Retail clothing store
- Medical clinic
- Automotive manufacturing company (e.g. Tesla)
- Transportation company (e.g. Uber)
- Beverage business (e.g. Nestlé bottled water brands)

Business process and functional areas

A business process is any activity performed to add value to basic resources to produce a product. A business process converts inputs into goods and services to generate profit for the business.

All businesses, regardless of size, have different functional areas that perform different business processes.

The main functional areas and their roles are:

- **Human resources (HR)** manage the labor and workforce. HR deals with the recruitment, compensation and motivation of the workforce. The human resources function ensures that people with appropriate skills are employed, trained and rewarded suitably for their work. The role of the HR specialist or department is to hire, train and dismiss employees, and to determine the appropriate compensation for them. Specific HR objectives vary from business to business depending on the size of the business. For example, the role of HR in a business with fewer than fifty employees is very different to its role in a business with operations in different countries and thousands of employees.
- **Finance and accounts** manage the organization's capital and assets. It deals with identifying, recording and communicating the economic events and transactions of a business. The finance and accounts function is to ensure that there are sufficient funds to produce the goods or services. To achieve this, the finance and accounts department oversees forecasting the financial requirements, keeping accurate records, procuring the necessary finance and ensuring proper payments for goods and services.
- **Marketing** is involved in understanding the needs and wants of consumers. The marketing function considers buyers' needs and wants and also conducts research into where and how consumers will buy a product and how much they will be willing to pay for it. By identifying these factors, the marketing department makes sure the business produces goods and services that consumers will be interested in buying.
- **Operations** manages the activities involved in the production of the product. The operations function oversees all aspects of the production process. The operations department is responsible for the quality of the materials, the production methods used and the control of stock to ensure that production is not interrupted.

As we will see throughout this course, each of these areas is responsible for key activities which are essential for the organization to achieve its goals. All the functional areas work together to make the business successful.

Businesses can gain competitive advantage by strategically focusing on one or more functional areas. Functional area strategies are based on chosen competitive priorities such as cost, quality, delivery, flexibility or innovation. For example, if a competitive priority is to be the lowest-cost producer, then a business will focus on operations, maximizing efficiency and reducing costs by implementing smart operation management systems.

Business sectors

Businesses are categorized into business sectors depending on the main activities they undertake. There are four major business sectors. Some businesses operate in more than one sector.

Primary sector

Businesses involved in primary sector activities extract and use natural resources to produce raw materials used by other businesses. These include businesses such as farming and mining. These businesses often employ a large amount of labor in

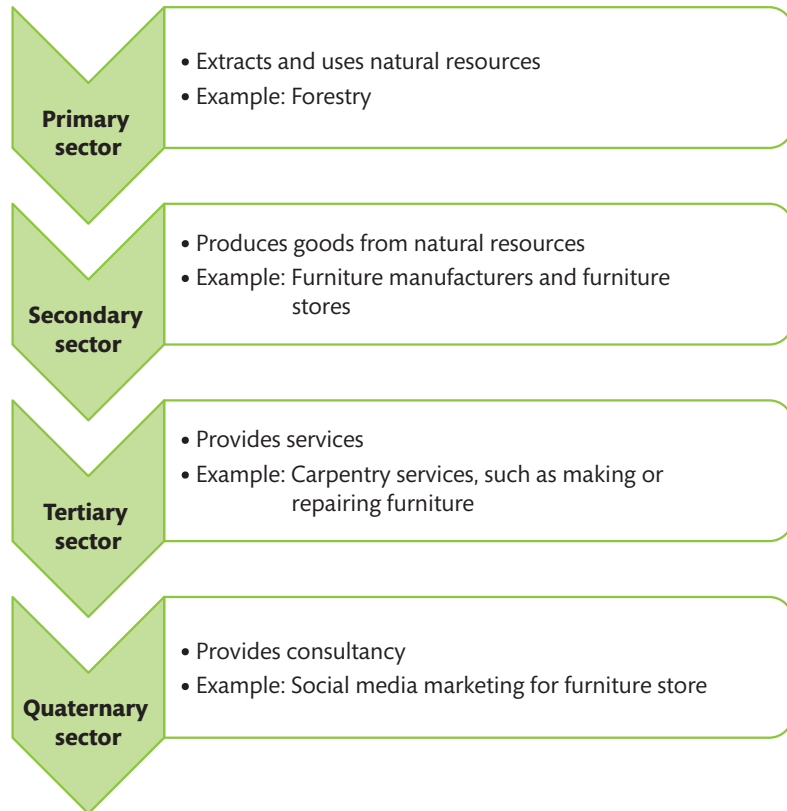


Figure 1.2 Business sectors work together to form the chain of production

developing economies (labor intensive), while in more developed economies, they make more use of machinery to extract the materials (capital intensive). The type of products produced by primary sector businesses have lower **value added** (the difference between the cost to extract the natural resource and the price at which it is



Figure 1.3 Fishing is an example of a primary sector business

sold). Natural resources or raw materials are sold, without any modifications, to other businesses or consumers. In the primary sector, there is not much difference between the cost and price of the product sold.

Secondary sector

The secondary sector consists of businesses that manufacture goods using natural resources and raw materials provided by the primary sector. For example, a business that buys oranges from the primary sector and transforms them into bottled orange juice is a secondary sector business.

These products have more value added as they have been transformed before being sold to customers. These customers might be local or international. Globalization has made it common to trade these goods with different parts of the world.

Tertiary sector

A business that sells services to consumers or other businesses, such as a bank, transportation company or insurance company, belongs to the tertiary sector.

In developed economies, the tertiary sector is more significant because people specialize in the provision of services that have higher value added.

The tertiary sector tends to employ a larger proportion of the labor in developed countries than in developing countries. According to the International Labour Organization (ILO), in Europe, more than 60 percent of the jobs created in 2021 were created in the tertiary sector. This figure falls to less than 35 percent in Africa.

Quaternary sector

The quaternary sector is comprised of businesses that provide services such as consultancy, research and development (R&D), information services or technology services. This sector requires a highly educated workforce because these services require deep knowledge of the areas in which businesses operate.

One example of the type of activity these businesses deal with is the creation of vaccines. This sector has experienced significant growth in recent years.



Figure 1.4 An orange juice manufacturer is an example of a secondary sector business

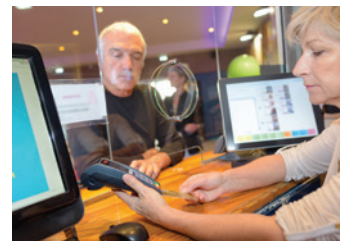


Figure 1.5 A bank is an example of a tertiary sector business

Info box

International Labour Organization (ILO): the only tripartite UN agency. Since 1919, the ILO has been bringing together governments, employers and workers of 187 member states to set labor standards, develop policies and devise programmes promoting decent work for all people.

Case study – Repsol



Repsol is a global energy company that operates in more than one sector across different countries.

One of the things the company does is to extract crude oil from the ground (primary sector) in places like South America and North America.

They then process the oil and transform it into fuel (secondary sector) in operations fields like the Shaw field located in the United Kingdom's North Sea.

Conceptual understanding: Ethics

An ethical business is one that tries to minimize any negative impact on the environment, its workforce or society. Ethical behavior can improve a business' image as well as customer loyalty.

Research and inquiry

Using an online search engine, find some examples of ethical businesses.

Finally, they sell it in their own fuel stations (tertiary sector) in countries like Spain or Peru.

- 1 Define the following terms:
 - a. primary sector
 - b. secondary sector
 - c. tertiary sector.

- 2 Identify the key differences between different business sectors.

Challenges and opportunities for starting up a business

Entrepreneurs have certain characteristics and skills that allow them to start a business. Entrepreneurs can be considered risk takers since they risk their capital and time to try to create goods or services that fulfil consumer wants and needs.

Entrepreneurs are proactive and they take the initiative when required. In addition, entrepreneurs have an understanding of the market within which their business operates, and are committed and motivated to the business that they have set up.

When starting a business, entrepreneurs face a variety of challenges that can put their business at risk. These are discussed below.

Financial challenges

When starting a business, entrepreneurs need money to invest in machinery, premises and raw materials, and to pay for services, such as registering their company, or a phone line and internet connection, etc.

This is the initial investment. Entrepreneurs also need to have the financial resources to cover these outgoings when the business starts operating. If the entrepreneurs hire people to work for them, they need to make sure they have enough money to pay the wages of their employees.

Entrepreneurs may need to ask for loans from banks or financial institutions in order to get their business started. Loans can be very difficult to secure when a business is new because there is no record of the business being able to pay back a loan.

The entrepreneur may be required to provide the bank with collateral, usually property, that the bank will sell off if the business is not able to repay the loan. Once the business is running, entrepreneurs need to make sure they have enough money to pay for the everyday expenses of the business.

This means they need to know what must be paid and when, and forecast whether this is something the business can pay with the money they get from selling their goods or services. If not, then entrepreneurs need to ask banks for loans or credit to cover those expenses until they sell the goods or services.

TOK

Consider the following questions within the context of the ethics of business management:

- What is an ethical organization?
- Are ethical companies more likely to be profitable in the long run than unethical ones?
- Does the concept of ethics have any role in deciding the optimal span of control for businesses?

Marketing challenges

One of the main challenges associated with marketing is the goods or services themselves. Sometimes, a business offers a good or service that doesn't meet the needs of customers.

Sometimes, the issue is with the price of the good or service, which might not be in line with the price set by competitors, making it less attractive for consumers.

Another common challenge is product/brand awareness. Consumers might not be aware of the existence of the good or service and, as a result, do not consider it when deciding what to buy. Finally, another challenge is the location of the product. A product might not be available for the target consumer to buy in their area.

Human resources challenges

It might be difficult for a business to hire the right people to do the work. This could be caused by a lack of suitable candidates, or a lack of appropriate skills among the applicants. This can be a result of the economy being in an **expansion cycle**, so suitable people are already employed and not looking for a job. The working conditions and salary that a business offers might not be attractive enough, which makes it even more difficult for a business to find the right people.

Production balance

Deciding on the right level of production when a business starts is a significant challenge for entrepreneurs. If entrepreneurs are cautious and do not produce much, they might find that demand is higher than expected. This could lead to a shortage in supply, which might have a negative impact on the business' image.

On the other hand, if entrepreneurs are too optimistic in their sales forecasts, this could generate an excess in supply, meaning the business has made an inefficient use of resources, particularly money, and might have to drastically reduce its prices to sell the available stock. This could have negative implications for its profits, making it difficult for the business to survive.

External factors

The success of a business not only depends on what the business does, but also on many factors it cannot control. These factors are known as external or exogenous influences. Examples include natural disasters, the economic situation of a country or region, or a pandemic.

An earthquake or flooding represents a challenge for a business located in the area where the natural disaster took place, because it has to struggle with the problems of the natural disaster, as well as trying to make the business succeed.

If an entrepreneur decides to start a business when the country or region where the business is located is going through a period of economic crisis, consumers' willingness to buy its goods or services might be lower than expected. This happens because consumers' incomes are usually reduced during an economic crisis. This is because many people lose their jobs, or the number of hours they work is reduced.

In the event of a pandemic, such as COVID-19, businesses may have to face the challenge of temporarily closing their doors. This results in them not being able to sell their goods and services, which is a key requirement for a business to survive, especially when it is a new business that has no profits saved from previous years.

On the other hand, businesses may thrive because of new opportunities.

Case study – Online learning: pivoting to face challenges during COVID-19

During the COVID-19 pandemic, students were not allowed to attend in-person classes because of a worldwide lockdown. The education industry had to change to meet new requirements as schools were forced to adapt to online teaching.

The pandemic highlighted the importance and potential of technology within the education sector.

Even after schools and universities were allowed to re-open, they are still using online resources to enhance the teaching and learning experience for educators and students.

Investment in the technology supporting education (sometimes called EdTech) has been increasing and many businesses continue to offer new and exciting ways to learn online. This drastic worldwide change presented opportunities for innovation in the EdTech world, which continue to support students and teachers.



The COVID-19 pandemic meant many schools had to rely on technology for online teaching

Conceptual understanding: Change

The COVID-19 pandemic is an example of an external factor that caused rapid and widespread change.

Identifying a gap in the market: When a business identifies that a good or service that consumers are willing to buy is not available in the market, this presents an opportunity for them. If the business is able to meet that demand with the goods or services they produce, they are presented with a chance to succeed by being the first to produce these goods or services. An example is pharmaceutical companies producing vitamins in a form aimed at children as a result of parents asking companies to develop them to complement their children's nutrition.

Operating in niche markets: Some businesses are created because the entrepreneurs behind them understand a very specific market. If the business decides to operate in a market that is relatively small and where there are few competitors, its chances of succeeding are greater if the entrepreneur has the specific knowledge needed regarding the goods and services sold.

Acting as innovators: Bringing innovative goods or services to the market will ensure the future success of the business. This could be done by innovating on products that already exist in the market or by creating totally new products.

Practice questions

LuxeGarm

Faizah is a founder of and designer at LuxeGarm. LuxeGarm is a garment and apparel manufacturing company. It was founded with the idea of providing luxury modest clothing. Faizah invested her own money into the business.

LuxeGarm's production processes include designing, material selection, cutting, stitching, ironing and packaging. Faizah has outsourced shipping and delivery to a courier company. She uses social media platforms for marketing and distribution. Social media platforms allow her to develop her brand and interact with customers to understand their needs and wants.

- Identify the resources needed for a garment and apparel manufacturing business. 4 marks
- List the business functional areas involved in operating a garment and apparel business. 4 marks
- Explain how LuxeGarm adds value to the final product and has a competitive advantage. 6 marks

Summary

- Business uses resources, also called inputs, to create products.
- Resources are categorized into capital, land, labor and enterprise.
- Business processes are organized into four main business functional areas:
 - human resources
 - finance and accounts
 - marketing
 - operations.
- Products can be divided into two main categories: goods and services.
- Goods are generally physical products, whereas services are not physical products.

Published by Pearson Education Limited, 80 Strand, London, WC2R 0RL.

<https://www.pearson.com/international-schools>

Text © Pearson Education Limited 2022

Typeset by © Straive

Original illustrations © Pearson Education Limited 2022

Illustrated by © Straive

Cover design © Pearson Education Limited 2022

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First published 2022

23 22 21 20

10 9 8 7 6 5 4 3 2 1

ISBN 978 1 292 44215 0

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Printed in Slovakia by Neografia

Acknowledgements:

Images:

Inside front cover: [[Shutterstock.com](https://www.shutterstock.com)/Dmitry Lobanov]

123RF: Auremar 7b; **Repsol:** Repsol, a Global Energy Company." REPSOL, 6 May 2022 8; **Shutterstock:** AnnaTamila 1, Wavebreakmedia 3, Atm2003 6, Hedgehog94 7t, Manuel Esteban 8, Fizkes 11.

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