

Chapter – 1

NATURE & PURPOSE OF BUSINESS

Introduction

Man is always busy with certain activities during his lifetime to earn his lively-hood. Broadly the human activities can be classified into two, they are Economic Activities and Non-Economic Activities.

1. **Economic Activities** – These are those activities that are undertaken to earn money or money's worth and related to production and exchange of wealth. Eg; Running a factory, Retail shop, Cultivating the land, etc.

Characteristics of Economic Activities.

- Economic Activities are related to the production of wealth.
- These are undertaken to satisfy human wants.
- They are performed with an expectation of earning money.
- It acts as a basis for the economic development of society.

2. **Non-economic Activities** – Non-economic activities are those activities which are undertaken not for any reward but for personal satisfaction. Example; A mother looks after her children, A house-wife cooks food for the family, Visiting Temples, etc.

Differences between Economic activities and Non-economic activities

ECONOMIC ACTIVITIES	NON-ECONOMIC ACTIVITIES
To earn money or money's worth	For personal or psychological satisfaction
It can be measured in terms of money	It cannot be measured in monetary terms
Money is the reward	Mental satisfaction is the reward

Types of Economic Activities

1. **Profession** - The term profession can be defined as an occupation that involves the rendering of personal service of a special and expert nature based on professional knowledge, education, and training. Examples; Doctors, Lawyers, C.A, etc.

Features of Profession:

- a. Professionals render personal service of special and expert nature.
- b. Income for the professional is the fees from their clients.
- c. Advanced education and training are necessary (MBBS – Bachelor of Medicine and Bachelor of Surgery, LLB – Legum Bachelareous (Bachelor of Laws)).
- d. Professionals are the members of a professional body. Examples; Doctors – Medical Council of India, Lawyers – Bar Council, C. A – Institute of Chartered Accountants of India).

Employment / Service– It is defined as a human occupation, in which the employee earns wage or salary by working for the employer under a contract of employment. Example; A clerk in an office, A worker in a factory, etc.

- 2 **Business** – Business is defined as the “repeated buying and selling or manufacturing of goods and services to earn profit which involves the creation of wealth.” Example; A factory, A retail shop, Commission agents, brokers, etc.

Characteristics of Business:

1. **Economic Activity** – because it is undertaken with the object of earning money or livelihood.
2. **Production or procurement of goods and services** – To offer the goods for consumption must be either produced or procured by the business enterprise. Goods may consist of consumable goods, industrial goods, or capital goods. Services include facilities offered to consumers in such as transportation, banking, insurance, electricity, etc. (Consumable goods – Pen, soap, sugar, etc., Industrial goods – Steel, cement, etc., Capital goods – Machinery, furniture, etc.)
3. **Sale or exchange of goods and services** – There should be a sale or exchange of goods or services between the seller and buyer. If goods are produced for personal use, they cannot be treated as a business. Eg: Cooking food for the family is not a business, but cooking food and selling it to others in a restaurant is a business.
4. **Regular Dealings** – business involves dealing in goods and services regularly. One single transaction of sale or purchase is not considered as a business. For example, if a person is selling his old car is not considered as a business.
5. **Earning Profit** – It is the main purpose of business. So that the businessmen should take all efforts to increase the profit by increasing sales volume or reducing the cost of production.
6. **Uncertainty of Return** – No business can predict its future profit as it is uncertain. Also, there is a possibility of loss being incurred.
7. **An element of Risk** – Every business is subject to risk due to various reasons like change in fashion, technological changes, increasing competition, fire, theft, accidents, natural calamities, etc.

Assignment: Differences between Profession, Employment, and Business

Classification of Business

Based on the size, business activities can be grouped into a small scale and large scale. Small scale business units require only a small amount of capital and they employ a lesser number of workers and the production is carried out on a small scale. Large scale business units invest a large amount of capital and produce goods on a large scale.

Based on ownership, a business can be classified into the public sector, private sector, and joint sector. If a business is owned by the government or any of its agencies, is called public enterprises. While the ownership is vested in the hands of private individuals, it is called private enterprises. Beyond this certain enterprises are owned partly by the government and partly by private individuals, they are called joint sector enterprises.

Based on functions businesses may broadly be classified into Industry and Commerce.

INDUSTRY

The term industry refers to that part of a business that is concerned with the production of goods and material. An industry may be classified into the primary industry, secondary industry, and tertiary industry.

Primary industries are concerned with the extracting, producing, and processing of natural resources. It may further be divided into extractive industries and genetic industries.

Secondary Industries are concerned with the materials which have already been produced at the primary stage, and they are again classified into Manufacturing industries and construction industries.

Tertiary Industries are providing support services to primary and secondary industries and it forms part of commerce. All service activities which are auxiliaries to trade like transport, banking, insurance, etc. fall under this category.

Extractive Industries are engaged in the extraction (collection) of useful materials from the earth and sea. Mining, fishing, agriculture, quarrying, etc. are examples of extractive industries. The products of these industries are either directly consumed or used as raw materials by other industries.

Genetic Industries are engaged in the reproduction or multiplication of plants and animals. E.g. Plant nurseries, Poultry farms, cattle breeding farms, etc.

Manufacturing Industries are engaged with the conversion of raw materials into finished

goods.

E.g. cotton into textiles, timber into furniture, etc. they change the form of goods i.e. raw material into finished goods and thus create form utility. Manufacturing industries usually produce consumer goods such as soap, cloth, toothpaste, etc., industrial goods such as steel, cement, etc. and Capital goods such as machinery and tools.

Types of Manufacturing Industries:

- a. **Analytical industry** – Separates different elements from the same material. Eg: oil refinery.
- b. **Synthetical industry** – Combines various ingredients into a new product. Eg: Cement.
- c. **Processing industry** – Go through successive stages for manufacturing a finished product. Eg: sugar, paper, etc.
- d. **Assembling industry** – Assembles different parts to make a new product. Eg: TV, Car, Mobile Phone, Computer, etc.

Construction Industries are engaged in the construction of buildings, dams, roads, bridges, etc. and they use the products of manufacturing industries and extractive industries.

COMMERCE

Commerce is concerned with the buying, selling, and distribution of commodities and it is an organized system for the exchange of goods and services between the businessman and the customers. It is also concerned with the marketing aspects of business, i.e. supply of the right type of goods to the right persons, at the right time and the right price. Thus commerce includes trade and aids to trade.

Definition – Commerce can be defined as the total of all those activities which are involved in the removal of hindrances in the process of exchange of goods.

Functions of Commerce –

1. **Removal of Hindrance of Person:** It refers to the lack of contact between the producers and customers. Here the trader acts as an intermediary among them and customers can find out the products which they are wanted from the market.
2. **Removal of Hindrance of Place:** It is a common problem that the producers and customers are in distant places, hence the commodities should be transferred from the production center to the hands of customers. This problem can be solved by the system of commerce using transport, packing, and insurance.
3. **Removal of Hindrance of Risk:** Goods and properties of business are subject to various risks such as fire, theft, damage, etc., and they have to be protected by ensuring the goods and properties.
4. **Removal of Hindrance of Time:** There may be a gap between production and consumption as the production is carried out in anticipation of future demands.

Therefore, it becomes necessary to store the goods until they are sold. This problem can be solved by warehousing.

5. **Removal of Hindrance of Knowledge:** Advertising helps in the removal of the hindrance of knowledge among the buyers.
6. **Removal of Hindrance of Finance:** The problem of finance can be handled by banks, which form part of commerce. It will also help the businessman in exchange of money between different persons at different places.

TRADE

Trade means buying and selling of goods, which involves the exchange of commodities for money or money's worth.

Types of Trade:

1. **Home Trade** - It is also known as domestic trade or internal trade. It means that the buying and selling of goods within the country and both the buyer and seller should belong to the same nation. Home trade is of two types:
 - a. **Wholesale Trade** - It implies that buying and selling in large quantities. A wholesaler buys goods directly from the producers and sells them to retailers.
 - b. **Retail Trade** - It involves buying and selling of goods in small quantities. A retail trader buys goods from the wholesalers and sells them to the customers.
2. **Foreign Trade** – It is also known as External trade or international trade. It involves the buying and selling of goods and services between the persons belonging to two or more countries. Foreign trade is of the following types:
 - a. **Export Trade** – It implies the sale of goods to foreign countries.
 - b. **Import Trade** – It refers to the purchase of goods from foreign countries.
 - c. **Entrepot Trade** – It means importing goods from one country to export them to some other countries.

Aids to Trade (Auxiliaries to Trade)

The activities which assist trade are called aids to trade or Auxiliaries to Trade. It includes Transport, Banking, Insurance, Warehousing, Advertising, etc. These service enterprises facilitate movements, storage, finance, risk coverage, and sales promotion of goods.

1. **Transport and Communication** – Usually production takes place in certain locations and consumption all over the country, for instance, tea is produced in Kerala and Assam, Jute in West Bengal, where there is an obstacle or barrier of place. This is removed by transport through various modes such as road, rail or water transport.

Along with transport there arises the need for communication. This will help producers, traders, and consumers in exchange for information. Postal service, telephones, and other modern means of communication may be regarded as auxiliaries to business activities.

2. **Banking and Finance** – All business concerns need funds for acquiring assets, raw materials, and meeting day to day expenses. Finance is the foundation of all businesses provided by banks. The banks accept deposits from the public and provide credit facilities for business. They generally lend money by providing overdraft and cash credit facilities, loans and advances and discounting of bills. Besides, they undertake the collection of cheques, remittance facilities, and various other services to the business community.
3. **Insurance** – In business, there are a lot of chances of risks such as damage to property and human resources (employees), such as fire, earthquake, theft, damage of goods in stock, and transit. Insurance has emerged for the fulfillment of this need. On payment of a nominal amount called a premium, the amount of loss or damage is compensated by the insurance company.
4. **Warehousing** – Production is always in anticipation of future demands so that the products are to be kept in good condition until they are sold. Storage of goods is done by warehouses specially constructed for this purpose. They facilitate the availability of goods when required. Thus warehousing stabilizes prices by equalizing supplies.
5. **Advertising** – It is an important device for promoting sales. It is not an easy task to reach millions of customers; therefore, promoting sales, information about the product must be made available to potential buyers through advertising. Thus advertising makes possible marketing of goods and services on a large scale.

Objectives of Business (Multiple Objectives of Business)

A business enterprise must have multiple objectives to satisfy different individuals and groups for its survival and prosperity.

- a. **Market Standing** – It refers to the position of an enterprise about its competitions by providing quality products and better service to its customers.
- b. **Innovations (Novelty)** – Innovation means the introduction of something new to the market.
It may be a new design, new quality for the existing product, a new method of production, etc.
- c. **Productivity** – Every enterprise should aim at greater efficiency and productivity by the best use of available resources.
- d. **Physical and financial resources** – The business enterprise must aim at acquiring physical resources like buildings, plants, and machinery, offices, etc. and financial resources or funds for its operations and ensure its efficient use.
- e. **Earning profits** - It is the most important aim of every business. Profit is regarded as the

lifeblood of a business to survive and to make growth and development of the enterprise.

- f. **Manager performance and development** – The enterprise should take much initiative to improve the efficiency of its managers by conducting various programs to motivate them.
- g. **Worker performance and attitude** – Every enterprise should aim at improving its workers' performance and their positive attitude.
- h. **Social responsibility** – It refers to the social obligations of business firms to contribute resources for solving social problems and to work in a socially desirable manner.

BUSINESS RISK

In simple words, risk means the possibility of loss. It can be defined as the chances of loss due to certain uncertain events in the future. It may be of two types, such as speculative risk and pure risk.

Speculative risk – It involves both chances of gain or loss. It arises due to a change in demand and supply, change in taste and habits of customers, etc. If the market condition is unfavorable it will result in again, otherwise, loss.

Pure risk – It involves the possibility of loss or even no loss. Fire, theft, earthquake, strike, etc. are examples of pure risks. If such events take place, it may result in loss, non-occurrence of which is explain the absence of loss, instead of gain.

Nature of Business Risks

- 1. It arises due to uncertainties.
- 2. It is an essential part of every business (Unavoidable).
- 3. The degree of risk depends on the nature and size of the business.
- 4. Profit is the reward for bearing risk.

Methods of dealing with risk

- 1. Not to enter high risky transactions.
- 2. Take precautionary measures like firefighting equipment etc.
- 3. Take an insurance policy to cover various risks.
- 4. Take measures like provision for bad debts, investment fluctuation fund, etc.

Causes of Business Risk

- 1. **Natural Causes:** It may include damages from a flood, fire, earthquake, etc.
- 2. **Human Causes:** It may arise due to certain human activities, such as theft, bad debt, mistakes, accidents, etc.
- 3. **Economic Causes:** It includes uncertainties relating to demand for products, competition, price, change in technology, rise in interest rate, higher taxes, etc.
- 4. **Other Causes:** Political disturbances, mechanical failures, change in exchange rates, etc. come under this category.

Starting a business – Basic Factors

1. **Selection of line of business** – It means the nature and type of business that an entrepreneur should choose to start his business.
2. **Size of the firm** – The promoter has to decide the size of the business, which may be either small scale, medium scale or large scale depends on the financial stability, future demand, etc.
3. **Choice of the form of ownership** – The promoter must decide whether he wants to start a sole proprietorship concern, partnership firm, a private company, a public company, or a cooperative society.
4. **Location of business** – It must be decided by considering factors like availability of land, electricity, water, accessibility to market, transportation, the scope for expansion, etc. Unscientific location affects the efficiency and profitability of the business.
5. **Financing the proposition (Capital needs)** – The promoter has to decide about business capital requirements and also find out the sources of finance. It may include short term or long term capital requirements, sources like shares, debentures or bank loans, cost of capital (interest or dividend), etc.
6. **Physical facilities** – It means the resources used to convert raw material into finished goods, which include buildings, machines, and equipment, skilled and unskilled workers, good quality raw materials, etc.
7. **Plant layout** – A proper arrangement of physical facilities like machines, equipment, and workers will result in a reduction of wastages, better use of available space, safety, and security to workers, etc. It also increases the profit of the business.
8. **Competent and committed workforce** – A scientific planning must be done by the businessman in calculating the number of employees (skilled and unskilled) to be appointed in various positions and their qualities.
9. **Tax planning** – Tax planning does not mean non-payment of tax. It means minimizing the taxes through better planning about the location (tax-free zones), size of the business, etc.
10. **Launching the enterprise** – After completing the above formalities, the entrepreneur can launch his business by mobilizing necessary resources, starting the production process, and initiating sales promotion activities.