FGE

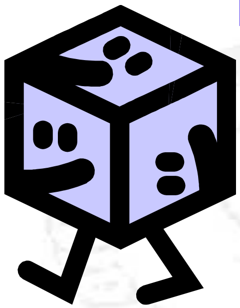
Gregory Asimakopoulos

***Email:** gasimako@ing.uc3m.es*

TOPIC 1. General concepts

- Concept and nature of business
- Business functional areas
- Management process
- The role the engineer in the Business management

Macroeconomic view: The business in the economc system



It is an **economic activity** that **transforms** a set of **inputs** (factors of production) into **outputs** (goods and services aimed to satisfy customers' needs and wants)

The term **circular flow of income** refers to a simple economic model which describes the reciprocal circulation of income between producers and consumers.

The continuous interaction of the markets of goods and services and factors determine a double flow: **monetary** and **real**, through which the economy of a country decides about what to produce, how and to whom.

EXAMPLE: Production process of bread

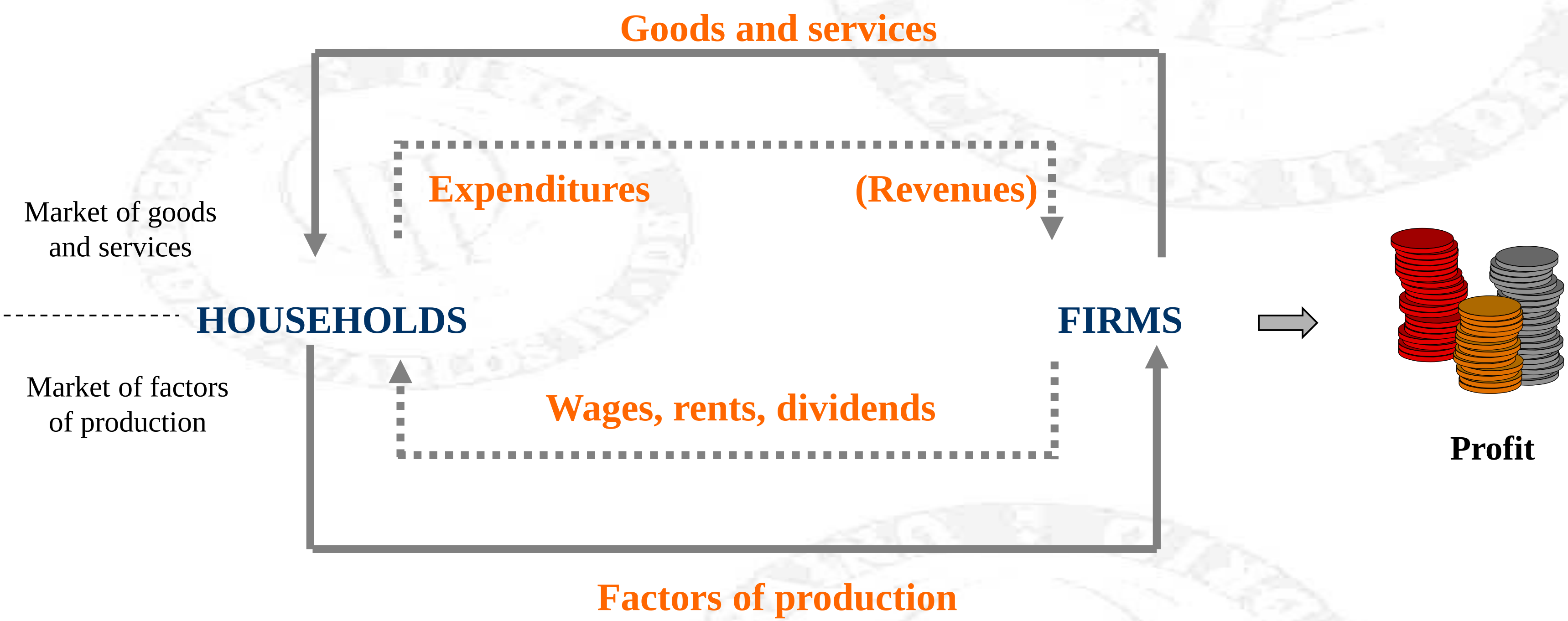
INPUTS

?

OUTPUT

Concept and nature of business

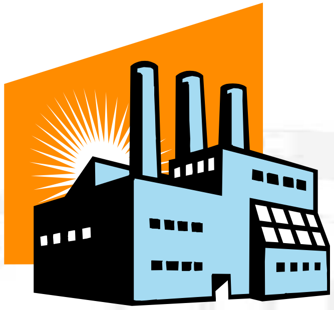
CIRCULAR FLOW OF INCOME



Basis economic agent that act in the economy are two:

Households

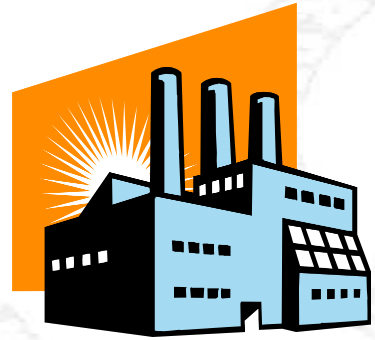
Firms



Households play a double role:

On one side, they are the owners of the production factors (land, labor, capital, technology and "know how").

On the other side, they are the elemental units of consumption



Moreover, firms use the production factor from households

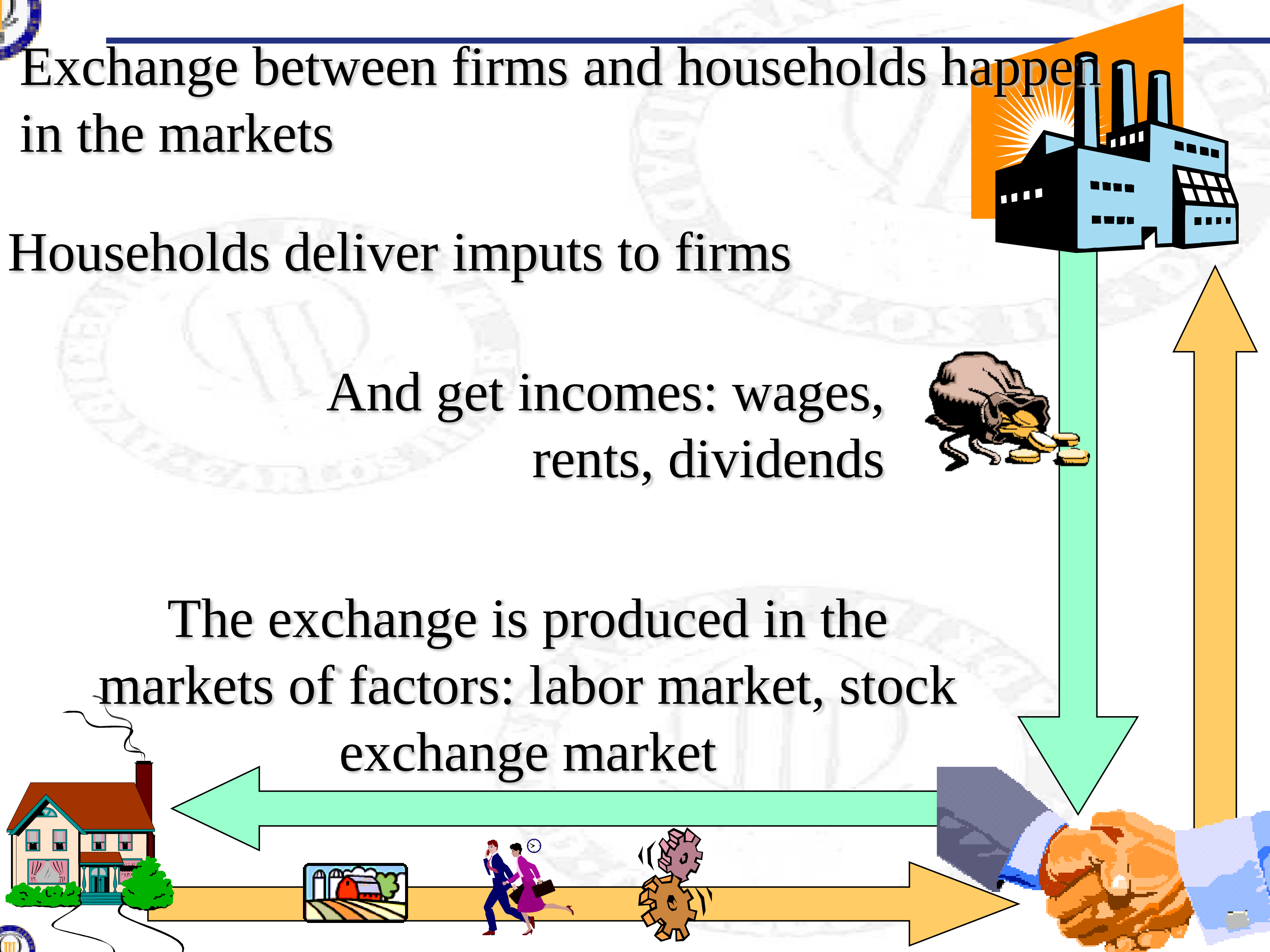
To produce goods and services that households demand

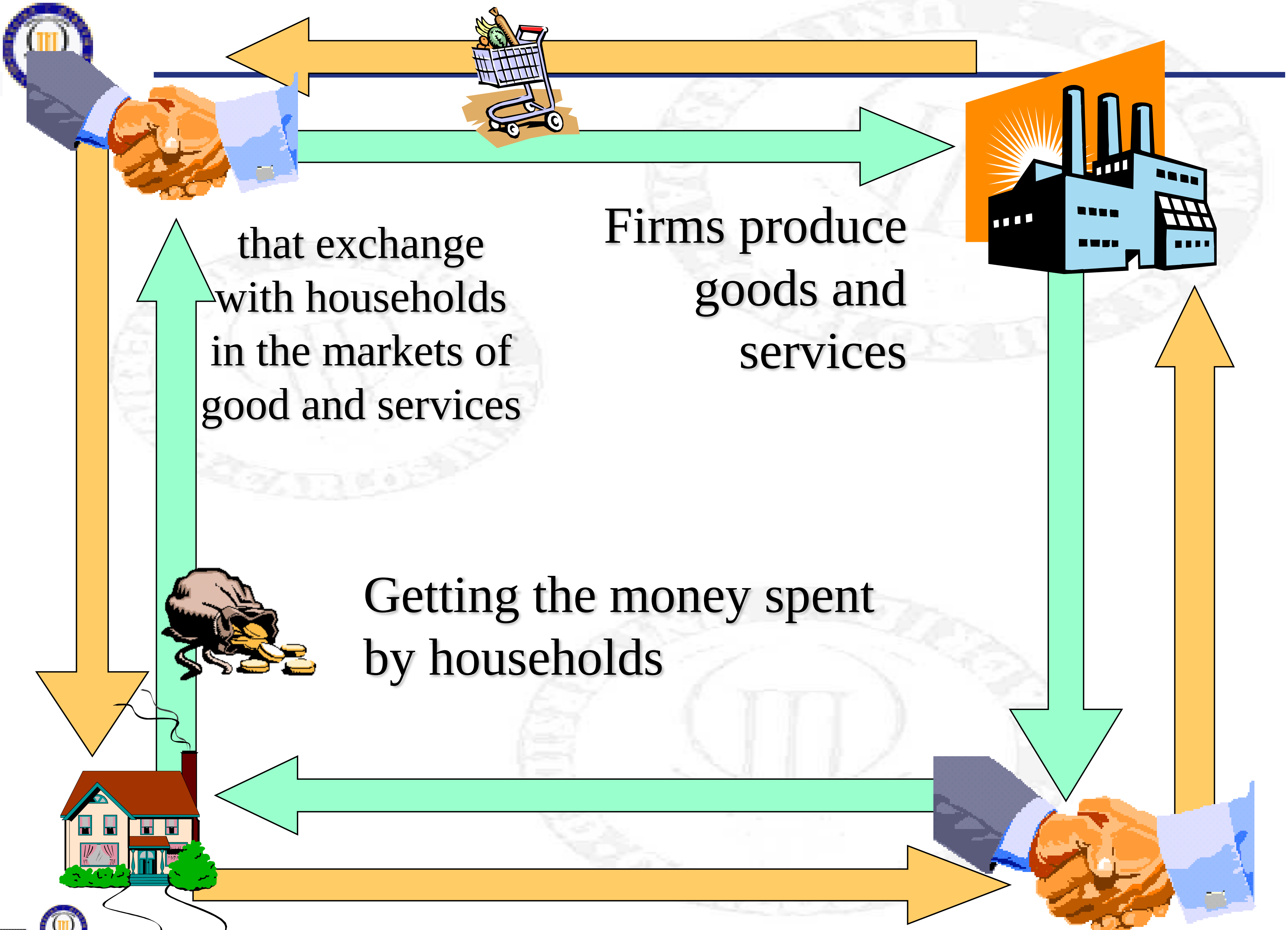
Exchange between firms and households happen in the markets

Households deliver imputs to firms

And get incomes: wages, rents, dividends

The exchange is produced in the markets of factors: labor market, stock exchange market




that exchange
with households
in the markets of
good and services
Firms produce
goods and
services
Getting the money spent
by households

In the economic system we can distinguish two types of flows: real flows

Which are goods, services and factors, and their monetary compensations

Financial flows

BUSINESS FUNCTIONS

REAL FUNCTIONS

- Related to supply (acquisition of inputs)
- Functions related to **production**
- Functions related to **marketing**

FINANCIAL FUNCTIONS

Financing and investing

MANAGEMENT FUNCTIONS

Planning, control and organization

3.The enterprise: Types y objectives

1. The enterprise and the entrepreneur. The role of the entrepreneur
2. Types of enterprises
3. Business objectives
    a. Traditional concept. The benefit maximization
    b. Emergence of new objectives. The role of interested parties (stakeholders)
4. Business strategies and types

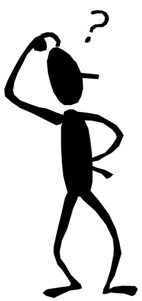
The enterprise and the entrepreneur

What is an entrepreneur?

Entrepreneur is a risk taker who starts and operates a business in hope of making a profit

Entrepreneurship is the process of bringing land, labour and capital together and taking the risk involved in producing a good or service in the hope of making a profit

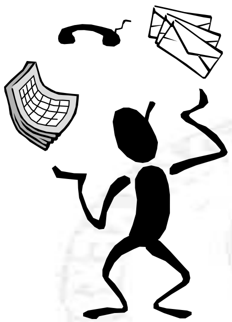
Who is the entrepreneur?



There is no conclusive agreement about **who the entrepreneur is** nor about his/her role in the enterprise. The entrepreneur’s duties are not clear, mainly in big companies where there are owners, management directors, moneylenders, ... who seem to share some of the characteristics attributed to a single person: the entrepreneur

The enterprise and the entrepreneur

Ideas about who is the entrepreneur



Entrepreneur ”Coordinator”

Entrepreneur “Risk Taker” (Knight, 1921)

Entrepreneur “Innovator” (Schumpeter, 1950)

Entrepreneur “On alert” (Kirzner, 1973)

Therefore, the entrepreneur’s functions are:

- **A person who coordinates and controls the productive process**
- **A person who ensures the payment of the factors of production**
- **A person who takes risky decisions**
- **A person who innovates**
- **A person who detects new business opportunities**

The enterprise and the entrepreneur

Internal Organization of the enterprise = Teamwork

Team production requires a CONTROLLER

What is the incentive for performing this task?

- To receive the residual income or surplus
- To control and reassign the other factors of production
- To be the central party in all the contracts signed with the inputs (raw mat, K, RH)
- To sell the mentioned rights

The entrepreneur is the person with all these *rights*

Types of enterprises. Classification criteria

Economic criteria

- Sector: primary, secondary and tertiary
- Size: big, medium and small
- Scope of the business: one market / multi-market; national / multinational

Legal criteria

Ownership of the factors of production

- Private companies
- State-owned co.

Main forms of business ownership

- Sole Proprietorship
- Partnership
- Corporation

Types of enterprises

Forms of business ownership

- Sole Proprietorship
- Partnership
  - General partnership
  - Limited liability partnership (LLP)
- Corporation
- Others
  - Cooperative Associations
  - Joint ventures
  - Mutual companies, etc.

The Sole Proprietorship

A **sole proprietorship** is a business owned by one person, who assumes all the risk, takes decisions and looks for business opportunities. Therefore, he/she owns all the rights

Advantages

1. Simple to start
2. Proprietor owns all profits
3. Personal satisfaction (being your own boss)
4. Sole decision maker
5. No tax on business as distinct from owner
6. Easy to dissolve

Disadvantages

1. Unlimited financial liability
2. Hard to raise funds for expansion
3. Often have no one to share management burden (one person's talents & skills)
4. Impermanence (it is not permanent)

A **partnership** is an association of two or more persons to carry on as co-owners of a business for profit. People form a partnership by entering into a partnership agreement

A **partnership agreement** is a written contract between the owners of a partnership that identifies the business and states the partner's respective rights and duties (name, location, type of business, sharing of profits, dissolving the partnership, etc.)

Advantages and disadvantages

Advantages of the Partnership

1. Few restrictions on starting
2. Pooling of funds, talents and borrowing power
3. More chance to specialize than the sole-proprietorship
4. No tax on business as distinct from owners

Disadvantages of the Partnership

1. Unlimited and joint financial liability
2. Potential for personal disagreements
3. Relative impermanence
4. Frozen investment

A **corporation** is a legally chartered organization that is a separate and legal entity apart from its owners. It has most of the rights that a person has

Advantages

1. Separate legal entity (shareholders are the owners)
2. Limited financial liability of owners
3. Permanence (it can exist forever)
4. Easy transfer of ownership (shares)
5. Greater financial capability

Disadvantages

1. Special and double taxation
2. Complex and costly to form and dissolve
3. Government regulation and public disclosure requirements

Separation of ownership - control (I/II)

Problem of separation of ownership - control:

Problem description:

- **Directors just look for their own benefit and the shareholder does not control their way of acting**

- **Companies are managed by Directors, who are employees and who take decisions and assume risks (professional)**

-**Directors may take decisions in their interest, disregarding their effect on shareholders**

- **Shareholders and directors have different access to information and different objectives**

- **Shareholders do not have enough information to assess the Directors' performance, nor incentives to do it. They do not have incentives, either, to improve the management of the business**

In large corporations, the Board of Directors guides the affairs of the business

Board of Directors looks for its own benefit

Conflict of interest among ownership and control

Agency problem

Separation of ownership and control (II/II)

Problem of separation ownership - control:

Description of the **solution**:

Shareholders are able to control the Directors' way of acting in order to avoid that they look for their own benefit

Mechanisms of control

- **Selecting the Board of Directors**
- **Contracts signed with Directors (goal linked)**
- **Requesting Audits**
- **Additional mechanisms of control: Indicators**

More and more, shareholders owning lots of shares are the ones taking decisions

A **cooperative association** is an incorporated organization whose user-members (owners) get back any revenue left after expenses are paid

Principles

1. Membership is open
2. Owned and democratically controlled by its members
3. Economic benefits are distributed proportionally according to each member's level of participation in the cooperative
4. Based on the values of self-help, self-responsibility, democracy and equality
5. Cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others

Some examples:

Employee Credit Unions

They accept savings deposits from members who own shares in the co-op. Members can borrow from the co-op. Savers receive interest, and borrowers pay interest

Agricultural co-ops

They help member farmers market their products

Buying co-ops

They help members buy their products at lower prices

Consumer co-ops

They operate customer-owned retail facilities. Consumers get together and form a buying pool to get quantity discounts and to replace the wholesalers and retailers

Other forms of business ownership

A **limited partnership** is a business in which one or more, but not all, of the partners are liable for the firm's debts only to the extent of their financial investment in the firm

A **joint venture** is a special type of partnership set up by individuals or firms to accomplish a specific task or project. It is very important and usual in international business

A **mutual company** is a corporation that issues no stock and is owned by its policyholders or depositors and whose surplus revenue, if any, is distributed among the owners in the form of dividends. Many insurance companies are mutual companies