

## 1.1 What is a business?

# The economy

Think of an everyday object, such as a simple pencil. Can you think of the inputs, people and processes that go into making of a pencil? Rarely do we think about the complexity involved in making simple, everyday objects. The video below describes the complexity of making a pencil. See how many of the inputs and processes you thought of!

## I, Pencil: The Movie



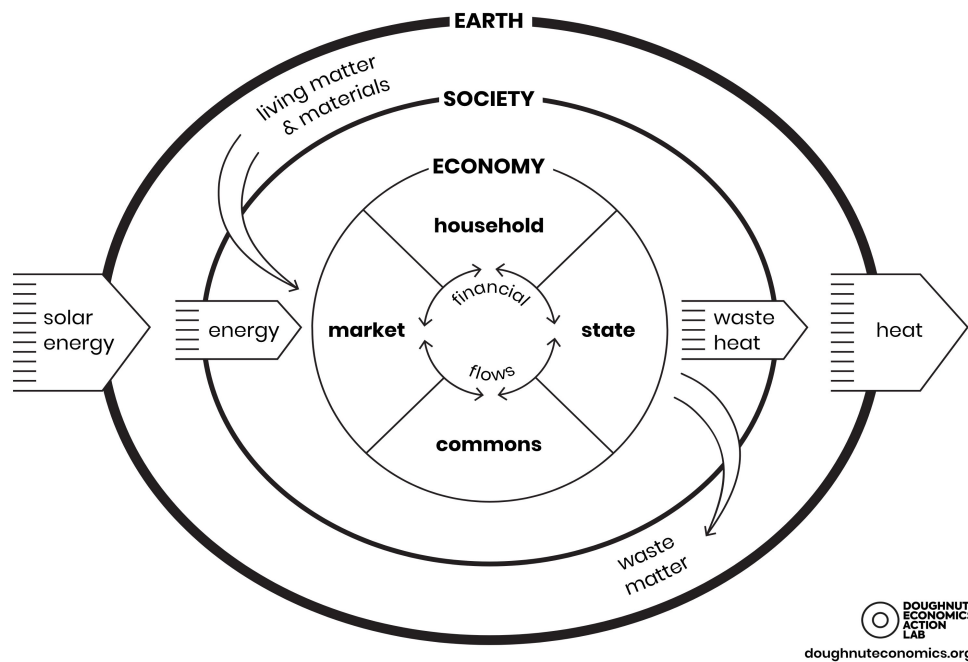
**Video 1.** The complicated and elaborate processes that go into making a simple pencil.

## What is the economy?

The example of a pencil is just one of many products that businesses produce in an economy. To understand the role of businesses in society, it is helpful to know what an economy is. The word ‘economics’ comes from the Greek philosopher Xenophon. It combines the word *oikos* (household) with *nomos* (rules or norms). So, economics is about managing a household. Nowadays we use the word *economy* to refer to a system for producing and distributing goods and services among a group of people. Businesses are part of that system.

Models can help us think about and understand how the economy works. You have seen models in your previous studies. For example, in science class, you may have seen a model of an atom. In economics, experts disagree about how to model an economy. This is because any model of an economy is a simplified version of reality. That means that the person making the model has to decide what information is included and excluded in the model.

This book is focused on the role of business in serving people and the planet. So, we will use the embedded economy model highlighted in Kate Raworth's book *Doughnut Economics* (see **Figure 1**).



**Figure 1.** The economy is part of (embedded in) society. Society is part of (embedded in) the natural environment.

Credit: Kate Raworth and Marcia Mihotich. CC-BY-SA 4.0

(<https://creativecommons.org/licenses/by-sa/4.0/>)

This model shows the natural environment, Earth, powered by energy from the Sun. The Earth contains all living things and human activity. Inputs of living matter and materials from the Earth are used by society and the economy to satisfy human needs and wants. Embedding both society and economy inside the natural environment is important. We need to understand that we are completely dependent on the resources from the Earth.

The centre of the model shows different systems and groups of people that distribute goods and services:

- **households** – important care services are provided between people with strong relationships. These goods and services are produced mainly with unpaid work;
- **state** – provides fundamental goods and services that everyone can access. These goods and services are provided often at no or a low price. They are funded mainly through taxes;
- **commons** – provides shared goods and services produced by society, or provides resources from Nature. People use and distribute goods, services and resources through self-organised systems. There is no payment; and
- **markets** – provides goods and services produced by businesses. Businesses produce and sell goods and services in exchange for money, for a price.

You can see that there are many ways to meet human needs and wants. There are many types of organisations that work to meet these human needs and wants, including businesses.

This course focuses mainly on markets and the state. But it is also important to recognise the key role of households and the commons in meeting human needs. When businesses work with the state, households and the commons, we can have healthier economies.

## Theory of Knowledge

In your Theory of knowledge course, you will discuss models and their uses and limitations. Models simplify reality. When we create models, we have to make choices about what to include and exclude in them. Experts often disagree about how to represent human and natural systems in models.

In the IBDP Economics course, a different model of the economy is used, called the circular flow model. This model creates different knowledge and, like all models, it has limitations. If you are taking the IB Economics course, it is interesting to compare the embedded economy model presented here and the circular flow model from the IB Economics course. You may learn about the choices that human scientists make when using models to create knowledge.

- How do the models we use in business management influence the knowledge we produce?

# Sectors of the economy

Another way of thinking about the economy is to focus on *what kinds of activities* are happening, and *what is being produced*. Economists identify four main sectors, or parts, of the economy.

## Primary sector

The primary sector refers to the extraction, or production, of raw materials from the Earth. The primary sector includes agriculture, fishing, forestry, mining and drilling. For most of human history almost everyone worked in the primary sector, mainly agriculture. In the last two hundred and fifty years, many people have left the primary sector to work in other sectors.



**Figure 2.** Producing crops is an example of a primary sector activity.

Credit: ArtistGNDphotography, Getty Images

The short video below from *The Economist* describes the primary resources that are found in a smartphone. Notice how many resources and countries are involved in the production of these resources.

Where does your phone come from?



**Video 2.** Demonstrating each of the elements that make up a smartphone.

## Secondary sector

The secondary sector refers to manufacturing and processing, where raw materials are made into products for sale. The biggest manufacturing businesses in the world include carmakers, electronics businesses that produce mobile phones, food processing companies, chemical businesses, and businesses in aeronautics and defence.



**Figure 3.** Producing cars is an example of a secondary sector activity.

Credit: RicAguiar, Getty Images

## Tertiary sector

The tertiary sector refers to any business that sells a service. The tertiary sector includes businesses that sell clothing and food, as well as education, healthcare, legal services, travel and transportation. Many, but not all, businesses in the tertiary sector are small. Large businesses in the tertiary sector include companies like Walmart, which sells a variety of goods, and banks.





**Figure 4.** Selling food in a restaurant is an example of tertiary sector activity.

Credit: d3sign, Getty Images

## Quaternary sector

The quaternary sector is a relatively new sector. It refers to services that focus on knowledge. As a service activity, the quaternary sector could be considered part of the tertiary sector. However, in the last fifty years, new businesses have started to focus on collecting, processing and selling information (or data). The quaternary sector also includes businesses that provide web-based services and many new kinds of media. Experts do not completely agree on exactly which activities are included in the quaternary sector. Some experts still classify these activities as a part of the tertiary sector.



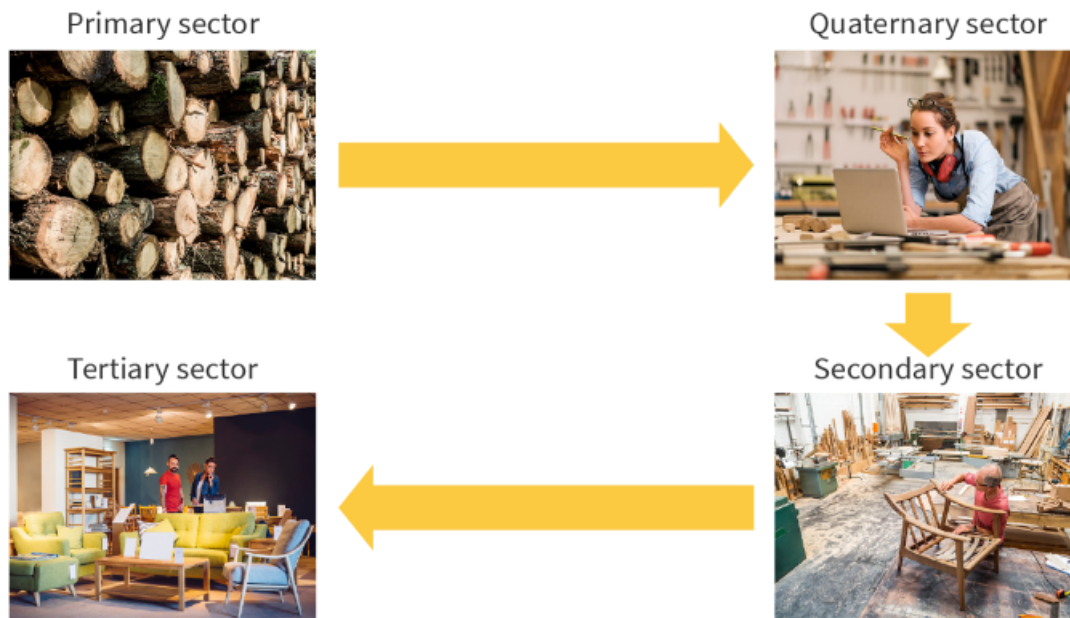
**Figure 5.** The quaternary sector involves digital media and information services.

Credit: Jay Yuno, Getty Images

## Dynamic nature of sector activity

Most products have passed through the primary, secondary, tertiary and perhaps quaternary sectors. The steps involved in creating products is called the supply chain. For example, the supply chain for producing a chair includes harvesting the timber (primary sector), using computer software to design the chair (quaternary sector), transforming the wood into the chair (secondary sector) and selling the chair in a shop (tertiary sector).





**Figure 6.** The supply chain for a chair may involve all four sectors.

Many businesses are only involved in a single sector. For example, a furniture store that buys finished chairs and sells them to the public is participating only in the tertiary sector. In contrast, a furniture maker that owns her own retail shop is participating in both the secondary and tertiary sectors.

Businesses whose activities involve two or more sectors are described as integrated businesses. For example, in the oil industry, large companies use digital technologies to help find and then drill for oil (quaternary and primary sector), refine it into usable products (secondary sector), and sell it in petrol stations (tertiary sector).

Firms in the same industry may take different approaches. For example, many automobile companies operate only in the secondary sector, manufacturing cars. The inputs are extracted and parts created by other firms, and the cars are sold by independent retailers. Tesla, however, has taken a different path and is, for example, creating its own batteries for its electric cars, and selling the cars in its own retail outlets.

Companies can also move in and out of different sectors over time. For example, when Apple began in the 1970s, it produced its own computers, and so was involved in the secondary sector. Apple has more recently outsourced production to other companies working in the secondary sector. On the other hand, the first Apple store was not opened until 2001. Prior to that, Apple's products were sold primarily through other retailers in the tertiary sector.



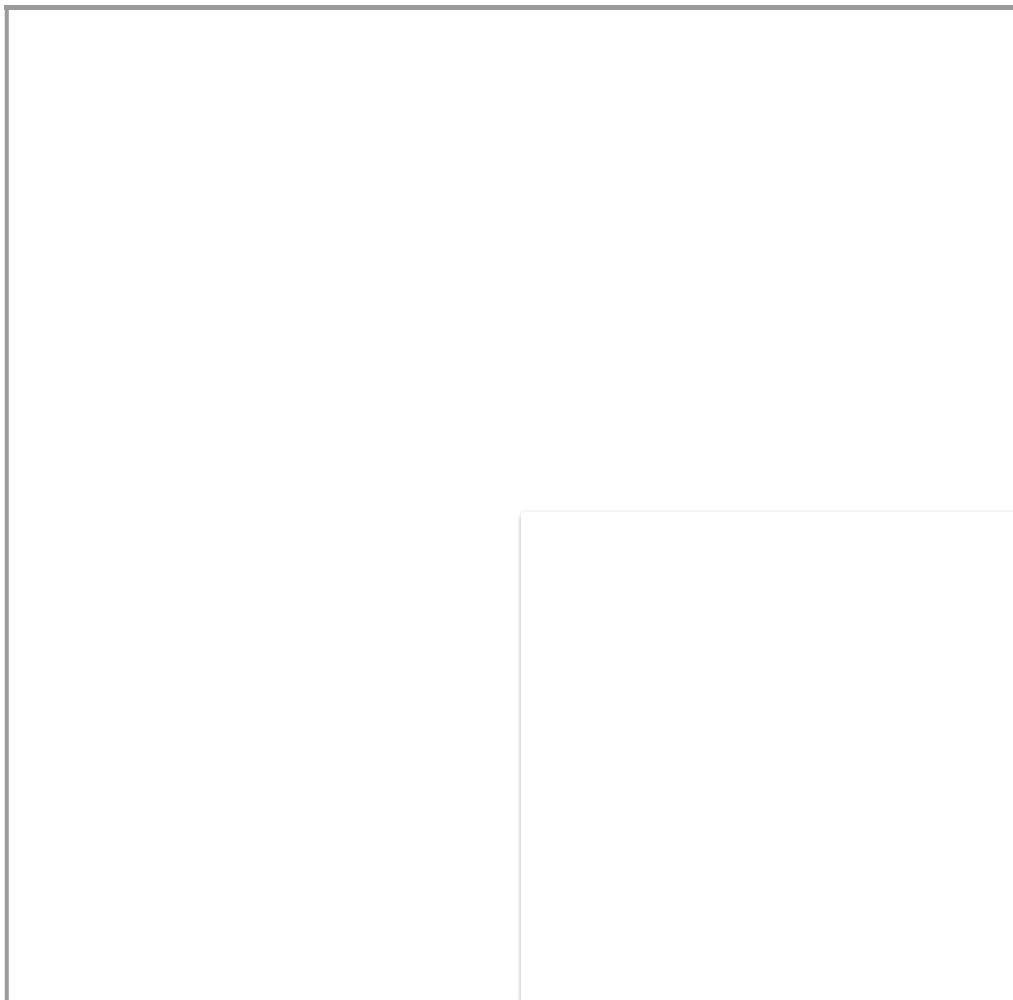
**Figure 7.** Apple moved into the tertiary sector later in the company's development.

Source: <https://commons.wikimedia.org/wiki/File:Applemorumbi.jpg> Diegogo08  
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The resources of a country, and its stage of economic development, have an influence on which sectors dominate the economy. Over time, as countries' economies have grown and incomes have risen, the primary sector has declined as a share of economic activity. There has been an increase in secondary sector activity. Then, in many countries, there has been a decline in secondary sector activity and increases in the tertiary and quaternary sectors. However, there are exceptions. For example, Saudi Arabia is a high-income country whose economic activity is still focused on the primary sector because of its large oil reserves. Some lower income countries, like the Maldives, may rely on tourism in the tertiary sector.

## Making connections

The IB DP Economics HL course goes into greater detail on the changes in sector activity over time, making links with the concept of income and elasticity of demand.



**Figure 8.** South Korea shows a common trend in its economic sector changes over time. The economy was focused on agriculture (primary sector) in 1911 but is now focused on services (tertiary sector).

## Case study

Fairphone (<https://www.fairphone.com/en/>) produces smartphones and was started in 2010. The business, based in the Netherlands, produces mobile phones with a circular business model. According to the [Ellen MacArthur Foundation](https://ellenmacarthurfoundation.org/topics/circular-economy-introduction/overview) (<https://ellenmacarthurfoundation.org/topics/circular-economy-introduction/overview>), circular business models require a company to:

- design out waste and pollution;
- circulate products and materials; and
- regenerate natural systems.

You will learn more about circular business models in [Section 1.3.7 \(/study/app/y12-business-management-a-sl-may-2024/sid-352-cid-174703/book/tool-circular-business-models-id-36853\)](/study/app/y12-business-management-a-sl-may-2024/sid-352-cid-174703/book/tool-circular-business-models-id-36853).



**Figure 9.** Fairphones.

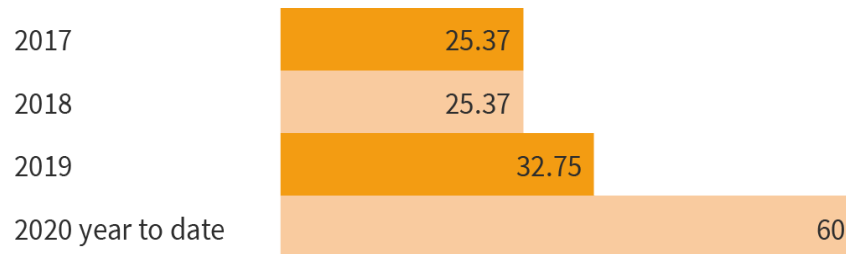
Credit: [Fairphone \(https://www.fairphone.com/en/\)](https://www.fairphone.com/en/).

Fairphone's smartphones are designed to minimise inputs and cycle materials to avoid e-waste. The phones are designed to be taken apart. Individual parts can be replaced if they are broken, or they can be upgraded if needed. Users can repair the phones and replace parts themselves. The business recovers old phones (also from other producers) from customers to recycle them. Fairphone also uses recycled metals and plastics.

Fairphone tries to get its primary sector inputs from suppliers who offer safe working conditions, where child labour is not being used and where local communities are benefitting from primary resource extraction (mining) activities. Fairphone is supporting other businesses to develop positive mining practices.

Socially, Fairphone works to support safe and fairly paid work. Environmentally, the company aims to reduce the negative ecological impact of mining activities. Where fair mining practices do not yet exist, Fairphone works with suppliers to develop them.

The company has been making progress in sourcing materials fairly (see **Figure 10**). The company has a target of 70% fairly sourced materials by 2023.



**Figure 10.** Percentage of fairly sourced materials in Fairphone's supply chain.

In the secondary sector, Fairphone is supporting human development by demanding that all work in the supply chain is voluntary, clean and healthy, and that there is no discrimination in the workplace and living wages are paid. The company is minimising the inputs of hazardous and non-hazardous materials in its supply chain. Suppliers will "identify, track, manage, reduce, and control air emissions emanating from [their] operations" and will reduce greenhouse and other gas emissions, energy consumption and noise pollution.

99% of the phones that Fairphone sells are sold to private individuals, but business consumers are increasing. By 2020, the business had sold more than 300,000 phones and had a profit of 2 million euros. The phones are sold through Fairphone's own website and through retail partners (<https://shop.fairphone.com/en/where-to-buy>) in Europe.

Sources:

Supply chain engagement: From risk to impact (<https://www.fairphone.com/wp-content/uploads/2020/11/Supply-Chain-Engagement-2020-final.pdf>)

Fairphone Ways of Working Together ([https://www.fairphone.com/wp-content/uploads/2019/07/updated-Code\\_of\\_Conduct\\_WEB.pdf](https://www.fairphone.com/wp-content/uploads/2019/07/updated-Code_of_Conduct_WEB.pdf))

Fairphone finds market for responsibly sourced mobiles  
(<https://www.reuters.com/markets/commodities/fairphone-finds-market-responsibly-sourced-mobiles-2021-12-03/>)

Fairphone 4 review: ethical repairable phone gets big upgrade  
(<https://www.theguardian.com/technology/2021/oct/15/fairphone-4-review-ethical-repairable-phone-gets-big-upgrade>)

### Questions

1. Outline **one** human need that Fairphone is meeting with its business. [2 marks]
2. Describe **two** of the sectors where Fairphone is operating. [4 marks]
3. Explain **one** way that Fairphone is acting responsibly towards people or the planet. [2 marks]