

## 1.1 What is a business?

# The nature and role of business

The COVID-19 pandemic hit businesses hard. Many businesses had to close for months or stop their activities entirely. The situation highlighted the strengths and weaknesses of many businesses and we now have a better understanding of what it takes for a business to be successful.

The rapid change to the external environment (the environment outside the business) caused by the pandemic required businesses to be creative, to consider new questions of ethics, and to find ways to achieve economic sustainability.

Businesses that were flexible during the pandemic were able to survive, sometimes even thrive, during the uncertainty and disruption caused. Other businesses failed quickly, with negative impacts for their stakeholders. The cafe below, for example, was able to keep its business growing during the pandemic even though customers were not allowed inside. Can you think of other examples of businesses that were able to continue their work in this way?



**Figure 1.** Businesses that were flexible survived the pandemic.

Credit: doble-d, Getty Images

A good example of how change can affect businesses differently is within the hospitality industry. Before the pandemic, some restaurants already had multiple ways of earning

money. For example, some were able to sell prepared food for take-out or delivery. These restaurants were able to shift focus more quickly than those who only served fresh food to order for customers eating inside the restaurant.

Restaurants with strong ties to the local community were supported by their neighbours; people in the community wanted to keep the character and services of their neighbourhoods. It is important to note that flexibility and strong networks help maintain strong and healthy businesses.

## Making connections

You can think of businesses as being in an ecosystem, like biological organisms. Strong ecosystems have resilience; they are able to survive a disruption in the ecosystem.

The topic of ecosystem resilience is very important in the IBDP Environmental Systems and Societies course. Like organisms in nature, businesses need to contribute to and be part of healthy ecosystems to thrive and to recover from disruptions.

This includes:

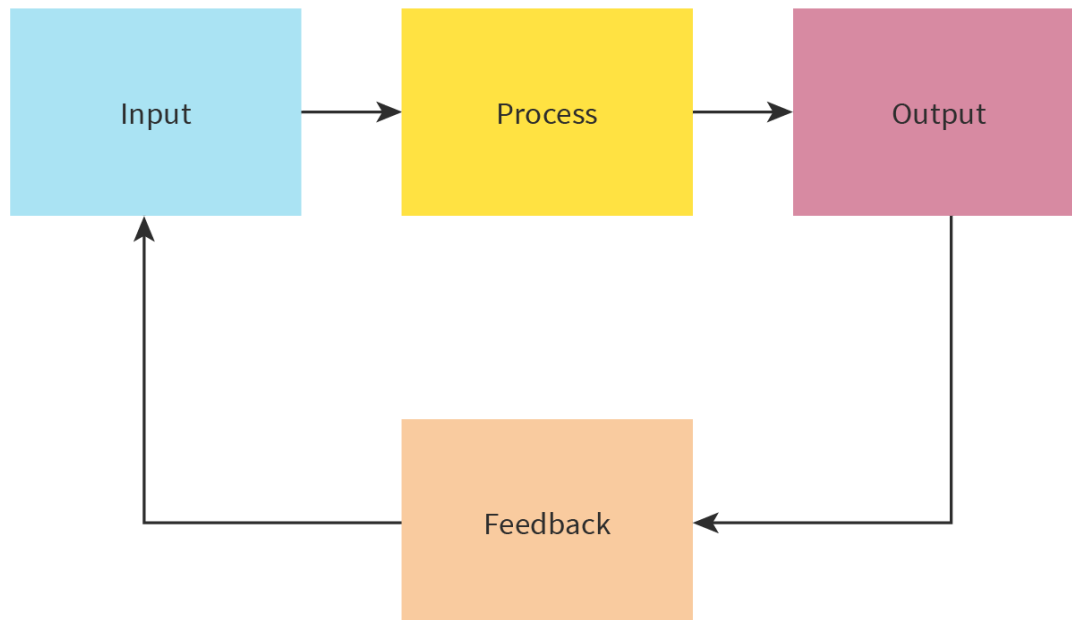
- in nature, developing strong networks among organisms. In business, developing strong networks among the people connected to the business;
- in nature, distributing nutrient stores. In business, distributing value among the people connected to the business; and
- in nature, supporting complexity and biodiversity. In business, understanding how complex business systems are and developing different business activities and stakeholders.

## Businesses are systems

A system is a set of interconnected parts that work together to make a more complex whole to achieve a purpose. Systems have inputs, processes, outputs and feedback.

A business is an example of a system. You have learned about other examples of systems throughout your studies. For example, you have probably learned about the digestive system in biology, or a political system in social sciences.

Systems are everywhere in the human and natural worlds and understanding them is important for everyone who wants to make change, including entrepreneurs who start businesses.



**Figure 2.** Systems have inputs, processes, outputs and feedback.

### Activity

**Learner profile:** Inquirers

**Approaches to learning:** Research skills (information literacy)

Sketch the basic system diagram from **Figure 2** onto a sheet of paper. As you read the following text about inputs, processes, outputs and feedback, add information you consider important to your diagram to extend the mind map.

## Inputs

The inputs of a business are all the resources needed to create a product. These resources belong to one of three categories:

- physical
- financial
- human

Physical resources include the raw materials and semi-finished goods that a business needs to produce its product. Raw materials include agricultural products like corn, timber, minerals like sodium, metals like aluminium, and crude oil. Semi-finished, or intermediate, goods have already been produced or processed in some way but are not consumer products. They may include inputs like steel that has been made from iron and can be used to make other products. Electronic components are another type of

intermediate goods purchased by companies. These are included in products like phones and automobiles. Physical resources also include capital goods such as equipment and machines that will be used to produce other goods. These might include computers or robots used to build goods.



**Figure 3.** Physical resources include wool (raw material) and the weaving machine (capital good).

Credit: hadynyah, Getty Images

Financial resources are the funds needed to set up a business. They are also used to grow the business and keep it running. Medium-term or long-term financing, which usually involves large sums of money borrowed for a longer time, may be used to purchase the business's physical building, like a factory, shop, or office space.

Businesses may also need large sums of money to buy capital equipment like machinery, desks and computers. Short-term financing in smaller amounts may be used to pay for inputs that will be turned into products and sold by the business. This would include the products that a business has in storage, called stock or inventory, at a retail

shop. Short-term financing could also be used for ongoing expenses like paying for electricity and employee salaries if the business is not yet earning enough money through selling its products.

Human resources are the people needed to run the business. They include managers and employees, as well as a more abstract element, called 'enterprise'. Enterprise is the process of taking risks to combine the other resources to create a good or service.

**Making connections**

In the IBDP Economics course, resources are often referred to as factors of production and are named differently:

- land (natural resources)
- labour (human resources)
- capital (physical and financial resources)
- entrepreneurship

**Processes**




Each business is unique. Businesses will combine their inputs in different ways to produce products. The process that a business uses to create its product will depend on the type of product, how and where it is sold, the number and skills of employees, the financing used, and the physical or intellectual work needed. The business will adapt these processes to react to change inside and outside the business.


In general, most businesses have four broad types of processes. They are sometimes called business functions. These four processes provide the structure for this course. **Table 1** outlines these functions; each one will be discussed thoroughly in separate subtopics.

**Table 1.** The four main business functions or processes.

Function		Processes
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Function		Processes
<b>Human resources management</b>	 <p>Credit: Tetra Images, Getty Images</p>	<p>Human resources management is the process that makes sure the business employs the correct number of skilled employees to produce and deliver its products. This process also involves ensuring that employees are treated ethically and in line with laws.</p>
<b>Finance and accounts</b>	 <p>Credit: echoevg, Getty Images</p>	<p>Financing and accounting processes ensure that the business has enough money to carry out its business activity over time.</p>
<b>Marketing</b>	 <p>Credit: Westend61, Getty Images</p>	<p>Marketing involves the process of selling the right product, at the right price, at the right time, to the right customers.</p>

Function		Processes
Operations	 <p>Credit: Nastasic, Getty Images</p>	<p>All businesses have a core business process (making a product, constructing houses, selling clothes, growing crops, etc.). Operations refers to how this core activity is carried out. Operations must plan how and in what quantity goods and services are to be produced.</p>

## Outputs

There are two main categories of business outputs:

Goods are tangible, meaning they have physical characteristics and can be measured. Examples include things like cupcakes, paper, tables and bicycles.

Services are intangible, meaning they cannot be touched or described by physical characteristics. Services include things like education, health care, and music concerts.

In some cases, it is hard to distinguish between goods and services. For example, when you go to a restaurant you consume food, which is a good. But in a restaurant, you also experience services, like cooking and serving the food. When a plumber comes to your home, they will identify the problem and propose a solution, which is a service. But the plumber may also sell you a new sink, which is tangible and therefore a good. The real world does not always fit neatly into business management categories.

## Feedback

Feedback is an important part of a system, but feedback is often overlooked. Feedback, or feedback loops, happen when the output of a system becomes an input to the same system.

## Making connections

Feedback loops are discussed in the IBDP Environmental Systems and Societies course. Negative and positive feedback loops are important concepts that originated in the sciences. They can also explain systems in other disciplines.

Feedback loops are everywhere, and you have likely experienced feedback during your studies. When you produce school work, you see a result and comments from your teacher. This information can be used the next time you complete an assignment to improve your work. It becomes feedback.

Another example is if you have had a fever. Your body sweats and evaporation carries heat away from your body to cool it. When your body temperature drops, you shiver to get warm again. The sweat and evaporation is the feedback that impacts your body to lower its temperature.

Both the feedback on your school work and your body's reaction to a fever are examples of negative feedback. Negative feedback occurs when the output feeds back into the inputs in a way that moves the system in the opposite direction. So, when you get feedback on your school work, it can help you change your work to improve it. When you sweat during a fever, it cools the body. Negative feedback helps keep systems stable and businesses use feedback from customers, suppliers, employees and the community to make improvements to the product or organisation. This can take processes in a new direction.

Positive feedback, on the other hand, is reinforcing. It moves systems and processes in the same direction. You may have also experienced this in your studies. If the feedback on your school work is delivered badly, it could demotivate you and cause you to produce lower quality work in the future.

In the natural world, as polar ice melts, dark patches of water are formed that absorb more light. This warms the ice further, creating even more dark patches. In business, a positive feedback loop may occur when a business has poor financial results, like losses. As a result, the business may decide to lower spending on new equipment. This can cause a decline in the quality of the product and lower revenue, making the losses worse. Of course, the positive feedback loop can also move in the other direction: good financial results, more spending on equipment, more revenue leading to better results.

When learning about negative and positive feedback loops, you may think that positive means something good and negative means something bad. This is not the case with feedback loops. The terms are not value judgements about how good or bad a process is.



Activity

**Learner profile:** Inquirers  
**Approaches to learning:** Research skills (information literacy)

On a piece of paper draw four columns, as indicated below:

Inputs	Process	Outputs <i>(Consider more than just the T-shirt)</i>	Feedback

Watch the following TED-Ed video about the life cycle of a T-shirt. While watching, take some notes (in the table that you have created) on the inputs, processes, outputs and any possible feedback loops you see and hear about.

The life cycle of a t-shirt - Angel Chang



**Video 1.** The lifecycle of a T-shirt. Considering how and where the average T-shirt is made and its environmental impact.