Chapter 1: Foundations of Business

Exercises — Exercises

Q1 Why is business considered as economic activity?

Economic activities are those carried out to earn a livelihood, as opposed to non-economic activities done out of love, sympathy, sentiment or patriotism. Business is an economic activity because it is undertaken to earn money through the production, purchase or sale of goods and services, with profit as the motive. It involves regular dealings with customers in exchange for value, and it can be run at a small individual level, like a shopkeeper's trade, or on a large organised scale, like a company. Since the effort is directed at earning income and not at emotion or charity, business is classed as an economic activity, along with profession and employment.

Q2 How does business contribute to the economic development of a country?

Business, which includes industry, trade and commerce, has been central to prosperity since ancient times. It produces and distributes the goods and services people need, and generates surplus income that is invested further. Trade and commerce encourage the growth of aids to trade such as transport, banking, finance and communication. Business creates employment and opportunities for professions, and entrepreneurs become job-providers. Historically, large exports and a favourable balance of trade made India known as 'Swaran Bhoomi'. After the 1991 reforms, business growth, investment and exports continue to support the economy, which is why business is regarded as its backbone.

Q3 State the different types of economic activities.

Economic activities are those through which people earn their livelihood. They are divided into three categories. (i) Business: an activity involving the production and sale of goods and services with the motive of earning profit, e.g. a shop or a factory. (ii) Profession: rendering personalised, expert services for a fee, after acquiring prescribed qualifications and following a code of conduct, e.g. doctors, lawyers and chartered accountants. (iii) Employment: work done for an employer under a service contract or rules of service in return for salary or wages, e.g. jobs in banks, insurance companies and government departments.

Q4 State the meaning of business.

The word business is derived from 'busy', meaning being busy. In a specific sense, business is an occupation in which people regularly engage in activities related to the purchase, production and/or sale of goods and services with a view to earning profit. It may be defined as an economic activity involving the production and sale of goods and services, undertaken with the motive of earning profit by satisfying human needs in society. Its main features are that it is an economic activity, involves regular dealings in goods and services, aims at profit, and carries uncertainty of return and an element of risk.

Q5 How would you classify business activities?

Business activities fall into two broad categories, industry and commerce. Industry is concerned with the production or processing of goods and materials. It is divided into primary industries (extractive and genetic), secondary industries (manufacturing and construction) and tertiary industries (supporting services). Commerce covers all activities needed to facilitate the exchange of goods and services. It includes trade, which is the buying and selling of goods, and auxiliaries to trade such as transport, banking, insurance, communication, advertisement, packaging and warehousing. Accordingly, business firms are classed as industrial or commercial enterprises.

Q6 What are the various types of industries?

Industries are of three broad types. (i) Primary industries extract natural resources or reproduce living organisms. They are extractive (farming, mining, lumbering, hunting, fishing) or genetic (seed and nursery companies, cattle breeding, poultry farms, fish hatcheries). (ii) Secondary industries process materials already extracted by the primary sector. They are manufacturing (analytical, synthetical, processing and assembling) or construction (buildings, dams, bridges, roads, tunnels). (iii) Tertiary industries provide support services to primary and secondary industries and to trade, such as transport, banking, insurance, warehousing, communication, packaging and advertising.

Q7 Explain any two business activities which are auxiliaries to trade.

Auxiliaries to trade are supportive services that facilitate industry and trade. Two examples are given below. (i) Transport: goods are produced in particular places, such as tea in Assam and jute in West Bengal, but are consumed everywhere. Transport by road, rail or coastal shipping removes the hindrance of place by carrying raw materials to factories and finished goods to markets. (ii) Insurance: business faces risks of fire, theft, accidents and damage to goods in stock or in transit. On payment of a premium, insurance provides protection and compensates the loss, removing the hindrance of risk.

Q8 What is the role of profit in business?

Profit is the excess of revenue over cost, and no business can survive for long without it. It is important because (i) it is a source of income for business persons, (ii) it can finance the expansion of the business, (iii) it indicates the efficient working of the business, (iv) it reflects the society's approval of the utility of the business, and (v) it builds the reputation of the enterprise. However, profit is a leading but not the only objective. Too much emphasis on it can make managers neglect customers, employees and society, which may lead to opposition and loss of business.

Q9 What is meant by business risk?

Business risk is the possibility of inadequate profits or even losses due to uncertainties or unexpected events. For example, demand for a product may fall because of changes in consumer taste or increased competition, or a shortage of raw materials may raise costs and reduce profit. Risk is uncertainty associated with exposure to loss. It is of two types: speculative risks, which involve a possibility of both gain and loss, arising from changes in market conditions; and pure risks, which involve only a possibility of loss or no loss, such as fire, theft or strikes. Risk can be minimised but never eliminated.

Q10 State the causes of risks involved in business?

Business risks arise from the following causes. (i) Natural causes: flood, earthquake, lightning, heavy rains and famine, over which humans have little control. (ii) Human causes: dishonesty or negligence of employees, stoppage of work due to power failure, strikes and riots, and management inefficiency. (iii) Economic causes: uncertainties of demand, competition, price, collection of dues, change in technology, and financial problems such as higher interest rates and taxes. (iv) Other causes: unforeseen events such as political disturbances, mechanical failures like the bursting of a boiler, and fluctuations in exchange rates.

Q11 Discuss the development of indigenous banking system in Indian subcontinent.

In ancient India, trade by land and sea, including the Silk Route and maritime trade, generated surplus income. People were engaged in agriculture, weaving, pottery, handicrafts and family workshops (karkhanas). This money was channelised into further investment and led to the growth of an indigenous banking system to finance trade. Hundi, meaning 'to collect', and Chitties in the south were documents that transferred money between parties. They were an unconditional promise or order to pay and could be transferred by valid negotiation. They were needed because long journeys carried the risk of theft and robbery. Credit transactions, loans and advances enhanced commerce. The subcontinent enjoyed a favourable balance of trade, and the banking system supplied traders and manufacturers with capital for expansion. Commercial and industrial banks later evolved to finance trade, and agricultural banks to give short and long-term loans to farmers. Different forms of Hundi, such as Darshani and Muddati, were practised by merchant communities. The Surat hundi was even honoured in far-off markets of Egypt and Iran.

Q12 Define business. Describe its important characteristics.

Business is an economic activity involving the production and sale of goods and services, undertaken with the motive of earning profit by satisfying human needs in society. Its characteristics are as follows. (i) An economic activity: it is done to earn a livelihood, not out of love or sympathy. (ii) Production or procurement of goods and services: a business either manufactures goods or acquires them from producers for sale. (iii) Sale or exchange: goods produced only for personal consumption do not make a business. (iv) Regular dealings: a single transaction, such as selling a household radio, is not business. (v) Profit earning: income by way of profit is a main purpose, and no business survives long without it. (vi) Uncertainty of return: the amount of profit is never certain, and losses are always possible. (vii) Element of risk: risk arises from changes in taste, competition, strikes, fire, theft or natural calamities, and no business can fully avoid it.

Q13 Compare business with profession and employment.

Business, profession and employment are the three types of economic activity, and they differ as follows. Mode of establishment: business starts with the entrepreneur's decision and legal formalities; a profession needs membership of a professional body and a certificate of practice; employment needs an appointment letter and service agreement. Nature of work: business provides goods and services to the public; a profession renders personalised expert services; an employee works as per the service contract. Qualification: none is necessary for business, but a profession requires prescribed qualifications and training, and employment requires those set by the employer. Reward: profit, professional fee, and salary or wages respectively. Capital: business needs capital according to its size, a profession needs limited capital, and employment needs none. Risk: business has uncertain profits and risk, a profession has regular fees with some risk, and employment has fixed pay with little or no risk. Transfer of interest is possible in business with formalities, but not in the others. Business has no prescribed code of conduct, a profession follows a professional code, and an employee follows the employer's norms. Examples are a shop, a legal or medical practice, and a bank job.

Q14 Define Industry. Explain various types of industries giving examples.

Industry refers to economic activities connected with the conversion of resources into useful goods, generally using mechanical appliances and technical skills. It covers producing or processing goods and breeding and raising animals. The term is also used for groups of firms producing similar goods, such as the cotton textile industry. Industries are of three types. (i) Primary industries extract and produce natural resources or reproduce living organisms. Extractive industries include farming, mining, lumbering and fishing. Genetic industries breed plants and animals, e.g. seed and nursery companies, poultry farms and fish hatcheries. (ii) Secondary industries use materials already extracted. Manufacturing industries are analytical (oil refinery), synthetical (cement), processing (sugar, paper) and assembling (television, car, computer). Construction industries build buildings, dams, bridges, roads, tunnels and canals. For example, mining iron ore is primary, while making steel is secondary. (iii) Tertiary industries provide support services such as transport, banking, insurance, warehousing, communication, packaging and

advertising.

Q15 Describe the activities relating to commerce.

Commerce covers all activities needed to maintain a free flow of goods and services between producers and consumers. It removes the hindrances of persons, place, time, risk, finance and information. It has two parts: trade, and auxiliaries to trade. Trade is the buying and selling of goods, and it removes the hindrance of persons by moving goods from producers to consumers. Auxiliaries to trade are: (i) transport and communication, which remove the hindrance of place and let producers, traders and consumers exchange information; (ii) banking and finance, which supply funds and also collect cheques and discount bills; (iii) insurance, which covers business risks against fire, theft and accidents; (iv) warehousing, which removes the hindrance of time by storing goods until needed and helps keep prices reasonable; and (v) advertising and public relations, which inform customers about products. Advertising is a paid activity, while PR is normally unpaid and builds a beneficial relationship.

Q16 Explain any five objectives of business.

A business needs several objectives because it must balance many needs, and objectives help it judge its own performance. Five of them are given below. (i) Market standing: maintaining goodwill and reputation, and offering competitive products at reasonable prices to customers, to hold a strong position against competitors. (ii) Innovation: introducing new ideas or methods in the way something is done or made, in products or in skills and activities. No business can flourish in a competitive world without it. (iii) Productivity: comparing the value of output with the value of inputs; a measure of efficiency, so every enterprise should aim at greater productivity through the best use of resources. (iv) Physical and financial resources: acquiring plants, machines and offices, and funds, and using them efficiently. (v) Earning profits: earning a reasonable profit on the capital employed, which is important for survival and growth. A sixth objective is social responsibility, meaning the obligation of business to contribute resources to solve social problems and to work in a socially desirable manner.

Q17 Explain the concept of business risk and its causes.

Business risk is the possibility of inadequate profits or even losses due to uncertainties or unexpected events, e.g. falling demand because of changed tastes, or rising raw material prices. Risks are speculative (a chance of gain or loss, from changes in market conditions) or pure (only a chance of loss, e.g. fire, theft, strikes). Its nature: risk is an essential part of every business and can be minimised but not eliminated; it arises from uncertainty; its degree depends on the nature and size of the business; and profit is the reward for risk taking, as 'no risk, no gain'. Its causes are: (i) natural causes such as floods, earthquakes and famine; (ii) human causes such as employee dishonesty or negligence, strikes, riots and management inefficiency; (iii) economic causes such as changes in demand, competition, prices, technology, interest rates and taxes; and (iv) other causes such as political disturbances, mechanical failures and exchange rate

fluctuations.

Q18 What factors are to be considered while starting a business? Explain.

Starting a business is entrepreneurship, and the person who does it is an entrepreneur. The following factors must be considered. (i) Selection of the type of business: the entrepreneur chooses the branch with greater profit potential, guided by customer requirements and his or her own technical knowledge and interest. (ii) Size of business: whether it will be small (MSME) or large, depending on expected demand and the capital available. (iii) Location: a wrong choice can raise costs; raw materials, labour, power, banking, transport, communication and warehousing influence it. (iv) Financing: capital for fixed assets, current assets and day-to-day expenses. (v) Physical facilities: machines, equipment, building and supportive services, depending on the nature and size of the business, funds and production process. (vi) Competent and committed workforce: skilled, unskilled and managerial staff, who are trained and motivated. (vii) Tax planning: considering tax liability under various tax laws and its impact on decisions. (viii) Launching the enterprise: mobilising resources, completing legal formalities, starting production and sales promotion, with financial planning for the capital required, its source and its best use. The enterprise may be a sole proprietorship, a partnership or a company.