1.1 Introduction to business management

In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing. Theodore Roosevelt (1858–1919), 26th president of the USA

SL/HL content	Assessment objective
The role of businesses in combining human, physical and financial resources to create goods and services	AO2
The main business functions and their roles: • human resources • finance and accounts • marketing • operations	AO2
Primary, secondary, tertiary and quaternary sectors	AO2
The nature of business activity in each sector and the impact of sectoral change on business activity	AO2
The role of entrepreneurship (and entrepreneur) and intrapreneurship (and intrapreneur) in overall business activity	AO3
Reasons for starting up a business or an enterprise	AO2
Common steps in the process of starting up a business or an enterprise	AO2
Problems that a new business or enterprise may face	AO2
The elements of a business plan	AO2

The role of businesses

The role of businesses in combining human, physical and financial resources to create goods and services. AO2

A **business** is a decision-making organization involved in the process of using inputs to produce goods and/or to provide services (see Figure 1.1.a). *Inputs* are the resources that a business uses in the production process, e.g. labour and raw materials. This process generates *outputs* (also known as products). The term **product** can refer to both goods and services. **Goods** are physical products, e.g. cars, computers, books and food. **Services** are intangible products, e.g. haircuts, bus rides, education and health care. Businesses can also provide goods and services to other organizations, such as freight transportation and distribution.

Management guru Peter Drucker famously said that the only purpose of a business is to create customers, i.e. the role of businesses is to combine human, physical and financial resources to create goods and services in order to satisfy the needs and wants of people, organizations and governments.

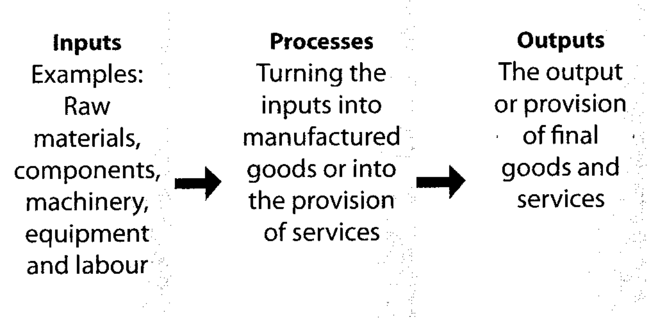


Figure 1.1.a The production process

Needs are the basic necessities that a person must have to survive, e.g. food, water, warmth, shelter and clothing. **Wants** are people's desires, i.e. the things they would like to have, e.g. a larger home, a new smartphone or to go on an overseas holiday.

Common mistake

The terms **customer** and **consumer** and are often used interchangeably by candidates, although they have different meanings. Make sure you can distinguish between the two concepts and use them in the right context – *customers* are the people or organizations that buy a product whereas *consumers* are the ones who actually use the product. These may be the same entity (e.g. someone who buys and eats a meal), but not necessarily such as parents (customers) paying for their children's (consumers) birthday presents.

Box 1.1.a Types of products

- **Consumer goods** are products sold to the general public, rather than to other businesses. They can be further split into *consumer durables* (products that last a long time and can be used repeatedly, e.g. electronic gadgets, cars, jewellery, clothes and home furniture), or *non-durables* (those that need to be consumed shortly after their purchase as they do not last or cannot be reused, e.g. fresh food, beverages, medicines and newspapers.
- **Capital goods** (or **producer goods**) are physical products bought by businesses to produce other goods and/or services. Examples include buildings (premises), computers, machinery, tools and specialist equipment.
- **Services** are intangible products provided by businesses. The service is not tangible, but the results are, e.g. health care, transportation, dining, sports (recreation) centres, legal advice, financial advice and education.

CORE

The main functions of business

The main business functions and their roles: human resources, finance and accounts, marketing and operations. AO2

For a business to operate effectively, tasks must be carried out by functional areas (or departments). These interdependent functional areas are: human resources, finance and accounts, marketing and operations management. The main business functional areas must work together in order to achieve the organization's goals.

Human resources – The human resources (HR) department is responsible for managing the personnel of the organization. In managing people, the HR department is likely to deal with the following issues: workforce planning, recruitment, training, appraisal, dismissals and redundancies, and outsourcing human resource strategies (see Unit 2.1).

Finance and accounts – The finance and accounts department is in charge of managing the organization's money. The finance and accounts director must ensure that accurate recording and reporting of financial documentation takes place. This is to comply with legal requirements (e.g. to prevent deliberate understating of profits to avoid corporate taxes) and to inform those interested in the financial position of the business (such as shareholders and potential investors). Finance and accounts topics are covered in Units 3.1–3.9.

Marketing – The marketing department is responsible for identifying and satisfying the needs and wants of customers. It is ultimately in charge of ensuring that the firm's products sell. This is done through a series of activities such as market research, test marketing, advertising and branding. Functions of the marketing department can be summed up as the traditional four Ps of marketing (see Unit 4.5):

- **Product** – ensuring that goods and services meet the customer's requirements, such as a product's various sizes, colours, packaging and core functions. Other roles related to the product include product differentiation and product position mapping (see Unit 4.2).

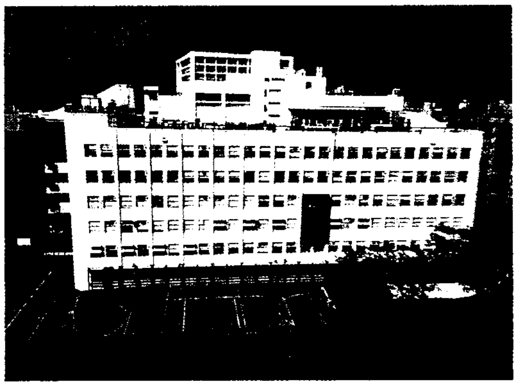
- **Price** – using various pricing strategies to sell the products of a business. Numerous pricing strategies (see Unit 4.5) can be used, depending on factors such as the level of demand, the costs of producing the good or service, and the number of substitute products available.

- **Promotion** – making sure that customers know about the firm's products. This is often done through the mass media, e.g. television and newspaper advertising. Alternatively, cheaper methods include the use of sales promotions, social networking and guerrilla marketing (see Unit 4.5).
- **Place** – ensuring that goods and services are available in convenient places for consumers to buy. Marketing managers must ensure that they select appropriate ways to distribute products to the marketplace, e.g. online purchases, retail outlets, vending machines.

Operations – Also known as **operations management** or **production**, this functional area of an organization is responsible for the process of converting raw materials and components into finished goods, ready for sale and delivery to customers. Examples of production include the extraction of crude oil, car manufacturing and the construction of roads. Operations also applies to the process of providing services to customers as in the case of hotels, restaurants, beauty salons and financial institutions. Operations topics are covered in Units 5.1–5.7.

A large organization is able to allocate resources to each of the four functional areas, making their roles easily identifiable. In a small business owned by just one person, each function would need to be carried out by the same person. In practice, the four functional areas of a business are highly interrelated, e.g. the production department relies on the talents of effective marketing staff to sell their products. Equally, marketers can only do their jobs if they have a decent product to sell and the necessary financial resources to do so.

Question 1.1.1 The business of education



Education is big business. Schools can earn **revenue** from numerous sources, such as tuition fees (for fee-paying schools), grants from the government and fund-raising events. They might also lease out their facilities (such as classrooms, sports hall, drama studios and swimming pool) during weekends and school holidays. Schools use the revenues to finance their **costs of production**, such as staff salaries and the maintenance of the buildings. Parents might also have to pay for items such as school uniform, textbooks, stationery, sports equipment and food.

(a) Distinguish between revenue and costs of production. *[3 marks]*

(b) Examine how business functions operate in an organization such as a school. *[6 marks]*

CORE

Business sectors

Primary, secondary, tertiary and quaternary sectors. AO2
The nature of business activity in each sector and the impact of sectoral change on business activity. AO2
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Businesses can be classified according to the stage of production that they are engaged in.

Primary sector

Businesses operating in the primary sector are involved with the extraction, harvesting and conversion of natural resources, e.g. agriculture, fishing, mining, forestry and oil extraction. Primary sector activities tend to account for a large percentage of output and employment in *less economically developed countries* (LEDCs). Businesses operating in the primary sector in *more economically developed countries* (MEDCs) use mechanisation and automation, such as combine harvesters and automatic watering systems.

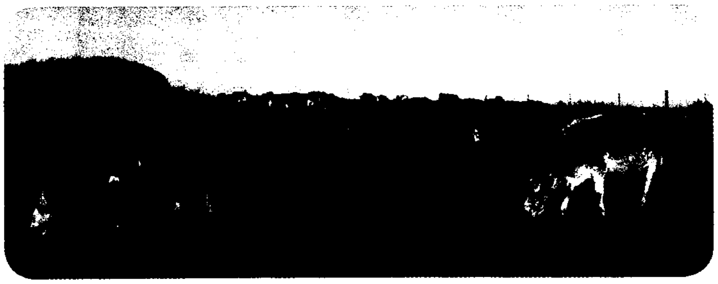

Figure 1.1.b Agriculture is part of the primary sector

As economies develop, there is less reliance on the primary sector in terms of employment and national output, partly because there is little **value added** in primary production (the difference between the value of inputs (the costs of production) and the value of outputs (the revenue received for the goods sold). For example, LEDCs can only sell tea leaves and coffee beans at relatively low prices.

Secondary sector

Businesses that operate in the secondary sector are involved in the manufacturing or construction of products, e.g. clothes manufacturers, publishing firms, breweries and bottlers, construction firms, electronics manufacturers and energy production companies. The output is then sold to customers, be they other businesses, governments, foreign buyers or domestic customers.

Economically developing countries tend to have a dominant secondary sector that accounts for a relatively large proportion of the country's national output. Economists argue that the secondary sector is the wealth-creating sector because manufactured goods can be exported worldwide to earn income for the country. Value is added to the natural resources used during the production process, e.g. the mass production and export of motor vehicles and consumer electronics have helped countries such as Taiwan and South Korea to prosper.

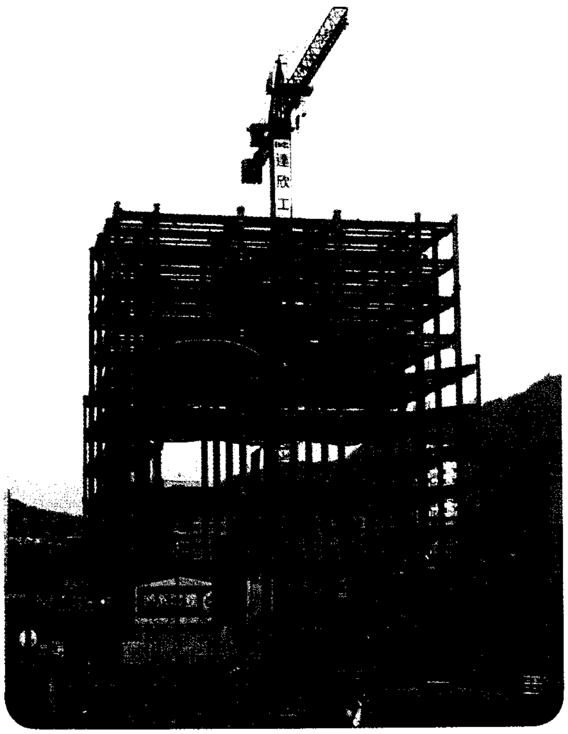

Figure 1.1.c Construction is part of the secondary sector

Tertiary sector

Businesses in the tertiary sector specialise in providing services to the general population. Examples of industries in the tertiary sector include: retailing, transportation and distribution, banking, finance, insurance, health care, leisure and tourism, and entertainment.

Note that goods can be transformed in the process of providing a service. This happens in a restaurant when the chef prepares a meal with fresh ingredients. The focus is, nevertheless, on the people who are providing the service – the chef and the waiting staff who serve the diners.

In MEDCs such as Canada and Germany, the tertiary sector tends to be the most substantial sector in terms of both employment and as a percentage of *gross domestic product* (the value of the country's output each year), e.g. in the USA and UK, around 80% of the labour force work in the tertiary sector. The decline of the manufacturing sector in MEDCs also signifies their growing reliance on the tertiary sector.

Figure 1.1.d Public transportation is part of the tertiary sector

Quaternary sector

A subcategory of the tertiary sector, businesses in the quaternary sector are involved in intellectual, knowledge-based activities that generate and share information. Examples include information communication technology (ICT), research and development (R&D), consultancy services, and scientific research. For example, pharmaceutical companies invest heavily in R&D to create innovative products, develop new production methods, improve efficiency, and to tap into markets. The quaternary sector exists mainly in MEDCs as it requires a highly educated workforce. It is also the sector in which businesses invest for further growth and evolution.

The four business sectors are linked through the **chain of production** which tracks the stages of an item's production, from the extraction of raw materials used to make the product all the way through to it being delivered to the consumer (see Figure 1.1.e).

Production

↓

Manufacturing

↓

Services (tertiary and quaternary output)

↓

Consumers

Figure 1.1.e The chain of production

All four business sectors are *interdependent* because each sector relies on the others to remain in existence. For example, raw materials such as crude oil, would not be extracted if there was no need for oil refinery whilst there would not be any need for oil refiners if there were no customers of the oil, such as motorists and airline companies in the tertiary sector. Likewise, firms in the secondary sector rely on their suppliers for stocks to ensure that their production targets are met. Businesses are also interdependent as they all need energy, ICT, manufactured producer goods, financial services and management consultants.

Sectoral change refers to a shift in the relative share of national output and employment that is attributed to each business sector over time. Typically, countries develop by shifting the majority of national output being contributed by the primary sector (such as agriculture, fishing and mining) to manufacturing and then eventually to the tertiary and quaternary sectors.

Primary sector production tends to yield low added value. In order to develop economically, there must be a shift in business activity to the manufacturing and service sectors which have higher added value. This process is known as industrialisation. Nevertheless, some countries are still able to exploit their natural advantage and specialisation in the supply of agricultural and primary products. For example, even though only 2% of the French population work in the primary sector, the country benefits immensely from its agricultural exports sold all around the world.

Automation and mechanisation in modern societies have caused decline in the secondary (manufacturing) sector in terms of employment.

More economically developed countries are able to exploit the tertiary and quaternary sectors as the main contributors to national output and employment. Businesses such as Apple and Samsung see themselves as operating in the services sector (they outsource production of their smartphones and computer hardware to manufacturers such as Foxconn). Apple realises that there is more added value in the tertiary sector – rather than receiving one-off payments from selling manufactured equipment, it can receive a flow of revenue from offering after-sales services such as maintenance and support services.

The sectoral change in MEDCs has been due to changes in several factors, including the ones below. These changes have created huge opportunities for the tertiary and quaternary sectors.

- Higher household incomes – The demand for services is positively correlated to changes in income levels. As a country develops, consumers demand more services such as dining out at restaurants, visits to the hairdresser and seeking advice on financial planning.
- More leisure time – A feature of higher standards of living is the increase in leisure time. As nations develop, people tend to have more time for leisure and recreation (such as sporting activities, visits to the theatre, and going on holiday).
- Greater focus on customer services – Firms have realised that good customer service before, during and after a sale can be an important source of competitive advantage.
- Increasing reliance on support services – Businesses need ever more sophisticated support services. Firms are increasingly relying on the services of other businesses, such as: sub-contractors, advertising agencies, market research analysts, technicians and management consultants. As businesses grow internationally, they will also increasingly rely on the services of financiers, accountants and lawyers.

Question 1.1.2 Production sectors

Study the data below and answer the questions that follow. A, B and C represent three countries: Germany, Pakistan and China (although not necessarily in that order).

Structure of employment (%)

	A	B	C
Agriculture	9	1	22
Manufacturing	47	28	24
Services	44	71	54

(a) Identify the countries A, B and C. *[3 marks]*

(b) Use the data in the table to justify your answer to part (a). *[7 marks]*

CORE

The role of entrepreneurship and intrapreneurship

The role of entrepreneurship (and entrepreneur) and intrapreneurship (and intrapreneur) in overall business activity. AO3

An entrepreneur is an individual who plans, organizes and manages a business, taking on financial risks in doing so. The term was coined by Richard Cantillon (1680–1734) an Irish-French economist. Entrepreneurship describes the trait of business leaders who tend to be distinctive in their temperament, attitude and outlook who drive the business. French economist and businessman Jean-Baptiste Say (1767–1832) described an entrepreneur as an individual who combines the other three factors of production (see Box 1.1.b) to produce a good or service. By selling the good or service produced, the entrepreneur pays rent for land, wages to labour and interest on capital – what remains is then the profit for risk taking.

Entrepreneurs have the skills needed to oversee the whole production process, whilst having the ability and willingness to take potentially high risks. Successful entrepreneurs tend to be creative, innovative and passionate. They search for and exploit business opportunities by forecasting and/or responding to changes in the marketplace.

Intrapreneurship is the act of being an entrepreneur but as an employee within a large organization. The term was coined by American entrepreneurs Gifford and Elizabeth Pinchot (1978), co-founders of the Bainbridge Graduate Institute in the USA. They described an **intrapreneur** as an employee who thinks and acts as an entrepreneur within a section of the organization. The intrapreneur is independent, proactive, creative, and generates new ideas and innovations to the organization. Hence, the intrapreneur takes direct responsibility and risks for turning a project or idea into a profitable finished product for the organization. As the intrapreneur thinks like an entrepreneur looking for business opportunities to increase profits, it is in the best interest of an organization to encourage intrapreneurship.

An example would be a project manager of a large company who is given the authority to exercise independent entrepreneurial initiatives to develop and launch a new product for the organization, or to lead a subsidiary of the organization. Companies such as 3M and Google are well known for promoting intrapreneurship. These companies encourage and fund intrapreneurs to create and oversee projects of their own choice.

Case study

Arthur Fry (born 1931) is credited for inventing and commercialising the Post-it note in 1980 whilst working as a new product development researcher at 3M. Post-it notes are now sold in over 100 countries around the world.

Case study

Paul Buchheit is an employee of Google, credited as the creator of Gmail. He programmed the first working version of Gmail in just one day(!), and has been the lead developer ever since.

Case study

Steve Jobs (1955–2011), the co-founder of Apple, did not graduate from university because his adoptive parents could not afford the tuition fees. Instead, he took the risk of setting up Apple with two friends in 1976. Jobs went on to reinvent computing, music and mobile phones, making Apple the highest valued company in the world, just two months before he died. *Forbes* estimated the wealth of Jobs to be more than $8.3 billion.

Box 1.1.b Factors of production

Factors of production are the four types of inputs or resources necessary for the production process.

- **Land** – natural resources used for production, e.g. wood, water, fish, crude oil, minerals, metal ores and physical land itself.
- **Labour** – the physical and mental efforts of people in the production of a good or service.
- **Capital** – all non-natural (manufactured) resources used in the production of other products, e.g. tools, machinery, buildings, equipment and vehicles.
- **Entrepreneurship** – the management, organization and planning of the other factors of production. The success or failure of a business rests on the talents and decisions of the entrepreneur.

Box 1.1.c Differences between entrepreneurs and intrapreneurs

Factors of production are the four types of inputs or resources necessary for the production process.

Entrepreneurs
- Owners and/or operator of organization
- Takes substantial risks
- Visionary
- Rewarded with profit
- Responsibility for workforce (labour)
- Failure incurs personal costs

Intrapreneurs
- Employees of organization
- Takes medium to high risks
- Innovative
- Rewarded with pay and remuneration
- Accountability to the owner / operator
- Failure is absorbed by the organization

CORE

Reasons for starting up a business

Reasons for starting up a business or an enterprise. AO2

There are several reasons why people decide to set up a business or an enterprise. These reasons can be remembered by the mnemonic GET CASH©:

Growth Entrepreneurs such as Donald Trump who own their own businesses benefit personally when there is an appreciation in the value of their assets, such as property and land which tend to increase in value over time. This is called capital growth. It is quite common for the capital growth of a business to be worth more than the value of the owners' salaries. Bill Gates, the world's wealthiest man, has made his fortunes mainly from the capital growth of Microsoft, the world's largest software-maker.

Earnings The Chinese have a saying that "You can never get rich earning money from working for someone else." That is because the potential returns from setting up your own business can easily outweigh the costs, even though the risks are high. It is common that entrepreneurs earn far in excess of salaries from any other occupation that they might otherwise pursue. Tim Cook, CEO of Apple, is reported to have an annual remuneration package of around $378 million!

Transference and inheritance In many societies it is the cultural norm to pass on assets, including businesses, to the next generation. Many self-employed entrepreneurs view their business as something that they can pass on (transference) to their children (inheritance) to give them a sense of security that might not be possible if they chose to work for someone else. The Walton family (the richest family in the world with an estimated wealth of over $150 billion) own over 50% of the shares in Walmart, the world's largest retailer.

Challenge Some people might view setting up and running a business as a challenge. It is this challenge that drives them to perform and what gives them personal satisfaction. Being successful in business boosts self-esteem. This is perhaps one reason why billionaires such as Warren Buffet, Carlos Slim and Li Ka-shing continue to work despite being past the official retirement age.

Autonomy Working for someone else means exactly that. Employees have to follow the instructions and rules set by the organization that they work for, such as the conditions of employment, working hours, benefits and holiday entitlement. Conversely, being self-employed means that there is autonomy (independence, freedom of choice and flexibility) in how things are done within the organization.

Security Similarly, there is usually more job security for someone who is their own boss. By contrast, employees can be dismissed, made redundant, or even replaced by technology. Although the risks are great, being self-employed also makes it potentially easier to accumulate personal wealth (financial security) to provide higher funds for (early) retirement.

CORE

Hobbies Some people might want to pursue their passion or to turn their hobby into a business. Successful entrepreneurs have a passion for what they do and this is made easier if the nature of the work is directly related to their interests. Top selling author, J.K. Rowling is an example. Jamie Oliver, the television celebrity and chef who has set up several of his own restaurants is another example. Internet entrepreneur Mark Zuckerberg who co-founded Facebook became the world's youngest billionaire when he was just 23 years of age.

Theory of knowledge

Look at the reasons for starting up a business. How do *reason* and *emotion* interact to affect the decision-making process? Is *emotion* or *reason* more important in this process?

Steps in the process of starting up a business

Common steps in the process of starting up a business or an enterprise. AO2

The steps in the process of starting up a business or an enterprise will vary from one country to another. The OCED reports that it takes an average of 13.4 days to set up a business in economically developed countries, whereas it takes 41 days in China and 119 days in Brazil! Nevertheless, the common steps in the process of starting up a business include:

1. **Write a business plan.** Once the entrepreneur has a feasible business idea, this is officially formulated in a business plan. This document will include the goals and objectives for the new business with an outline plan of how these targets are to be accomplished.

2. **Obtain start-up capital.** Starting a business requires money. Quite often, small business owners will use their own savings and/or obtain loans to finance their start-up. The loan process can take several months to complete, with the lender usually requesting a completed business plan before any funds are approved.

3. **Obtain business registration.** Before a business can trade or hire workers, it must satisfy registration and licensing requirements. The owner(s) must also register the legal status of the business, i.e. the type of business organization, such as a partnership or limited liability company (see Unit 1.2).

4. **Open a business bank account.** To facilitate the financial operations of the new business, the owner(s) need to set up a business bank account. This allows the business to pay for its costs of operation and to receive payments from customers (whether through bank deposits of cash, bank account transfers or credit card payments). Almost all business bank accounts will have online banking facilities too.

5. **Marketing.** Potential customers need to know about the business and its products. This is done through the marketing activities of the new business, such as advertising and other promotional materials. For many businesses, this will also include establishing a presence on the internet. Having an effective website is essential to capture business opportunities with new customers and to establish credibility.

Starting a new business is highly risky because the owners and investors are taking a step into the unknown, even if risks are calculated. Most new business ideas fail, mainly due to mismanagement. For example, the owners might have underestimated the challenges faced when setting up a business or being self-employed. The level of demand for the firm's products might not be sufficient for it to recoup its start-up costs (see Box 1.1.d), let alone to earn any profit. Nevertheless, the pursuit of profit remains a key incentive for entrepreneurs to take such risks. Careful consideration of various factors (see Table 1.1.a) in the business plan can also reduce the risks of setting up a new business.

Box 1.1.d Examples of start-up costs for a new business

- **Premises**, e.g. purchase costs, mortgage deposit payment or rental deposit costs.
- **Buildings**, e.g. alterations, fixtures and fittings and insurance costs.
- **Capital equipment**, e.g. office furniture, telephones, computers, machinery, tools, and motor vehicles.
- **Legal and professional fees**, e.g. costs of solicitors, licenses, permits and copyright permission.
- **Marketing costs**, e.g. market research, advertising and promotional campaigns.
- **Human resources**, e.g. recruitment, induction and training costs.

Table 1.1.a Factors to consider when setting up a business

Factor	Description
Business idea	A feasible business idea is needed. This might be done by identifying and filling a *niche* (unfilled gap) in a market or by providing products that have a *unique selling point*. Amazon.com (online book retailing), Dell (custom-made computers) and Dyson (bag-less vacuum cleaners) are examples of successful businesses based on innovative ideas. It is also possible to enter existing markets although these may be saturated so the chances of success might be lower.
Finance	Finance is needed to fund business activities, such as manufacturing and marketing of the firm's products. However, finance is usually the key barrier to setting up a new business. Record keeping of financial accounts (see Unit 3.4) also needs to be done. Many firms will hire accountants to help them do this.
Human resources	Human resources are needed at all stages of business activity, from the design and development of a product to delivering it to the consumer. Entrepreneurs have to consider the need for hiring, training, retaining and motivating their staff.
Enterprise	Entrepreneurial skills are required to successfully plan, organize and manage the business. Effective leadership and negotiation skills are required to deal with different *stakeholder groups* (see Unit 1.4) such as employees, suppliers and the government. Entrepreneurs must also have self-confidence and a passion for what they do.
Fixed assets	Fixed assets are needed, such as premises and capital equipment. The location decision (see Unit 5.4) is also a crucial but a problematic one; a popular location improves the chances of attracting customers, but the cost of land and property is much greater.
Suppliers	Suppliers are needed to provide the business with its raw materials, finished stock of products and support services. Negotiations over issues such as prices and delivery times also need to be undertaken.
Customers	Customers need to be attracted because without them the business will fail. This might be done by using market research to create products that are desirable, available at the right prices and sold in the right places.
Marketing	Marketing is essential, irrespective of how good a business idea might be. Many investors turned down Anita Roddick's idea of The Body Shop and J.K. Rowling's Harry Potter books. Marketing is needed to convince lenders and buyers that the product is a winner.
Legal issues	Legalities (legal issues) also need to be considered, e.g. consumer protection laws, copyright and patent legislation and employment rights. Infringement of legal issues can present huge problems for a business, e.g. if a restaurant breaks food hygiene laws, it might be required to cease all operations.

Problems that a new business may face

Problems that a new business or enterprise may face. AO2

Results from around the world consistently show that around 20 to 25 per cent of new businesses fail in their first year. A new business is likely to face problems that must be dealt with immediately to prevent them from escalating and threatening its survival. Such problems include:

- **Lack of finance** All businesses need finance for the purchase of *fixed assets*, such as premises, buildings, machinery and equipment. However, most owners of new or small businesses do not have the credentials to secure external funding without major difficulties. Even if entrepreneurs are able to borrow money, the funds may be insufficient or the relatively high interest charges might seriously affect the cash flow position of the firm (see Unit 3.7). Hence, new business owners often have to remortgage their own homes to raise the finance needed, thereby offering the lender more *collateral* (financial security in case borrowers fail to repay the loan).

- **Cash flow problems** Financing working capital (the money available for the daily running of a business) is also a major problem for many new businesses. A business might have a lot of stock, such as raw materials or semi-finished output, which cannot be easily turned into cash. Customers might demand a lengthy credit period (buy now pay later schemes), i.e. the business will not receive the cash payment until the credit period is over (usually between 30 to 60 days). However, businesses still need to pay for their on-going costs such as wages, rent, utility bills, taxes and interest payments on bank loans. A lack of working capital is the single largest cause of business failure. Hence, it is common for a new business to produce a cash flow forecast in the business plan so that provisions can be taken to cover any shortfalls.

- **Marketing problems** Marketing problems arise when businesses fail to meet customer needs, thereby resulting in poor sales. Supplying the right products at the right price is especially crucial for new businesses. However, small and new businesses might lack the know-how to do this. Quite often, the key to small business success is to identify a *niche* (or gap) in the market and then fill it. For example, Amazon.com identified huge opportunities of using the Internet as a channel of distribution for books and other products. European airlines such as easyJet and Ryanair identified early on the niche for no-frills (budget) air travel.

- **Unestablished customer base** A major problem facing new businesses is attracting customers, i.e. building a customer base. The problem is intensified when there are well established rivals that already operate in the market. Customer loyalty is built over a long period of time, which may require marketing know-how and large amounts of money.

- **People management problems** New businesses may lack experience in hiring the right staff with all the necessary skills. This can lead to poor levels of customer service and the need to retrain staff or to rehire people, all of which can be very expensive. Moreover, new businesses might not know the ideal *organizational structure* (see Unit 2.2) that best suits their needs.

- **Legalities** It is necessary for businesses to comply with all necessary legislation, e.g. business registration procedures, insurance cover for staff and buildings, consumer protection laws and copyright rules. The paperwork and legal requirements of setting up a new business can be tedious, confusing, time consuming and expensive. Any oversight could result in the business having to pay compensation or penalty fees. This would obviously damage the already vulnerable cash flow position of new businesses.

- **Production problems** It can be difficult for new businesses to accurately forecast levels of demand so they are more likely to either over produce or under produce. Overproduction tends to lead to stockpiling, wastage and increased costs (see Unit 5.5). By contrast, underproduction leads to dissatisfied customers and a loss of potential sales.

- **High production costs** New businesses are likely to experience high production costs due to the large amount of money needed to pay for the cost of equipment, machinery, stocks (inventory), rent, advertising, insurance and so forth. Smaller businesses will also be at a cost disadvantage as they cannot benefit from *economies of scale* (see Unit 1.6). By contrast, economies of scale allow larger and more established businesses to benefit from lower average costs of production due to their scale of operations, such as being able to get discounts from their suppliers for bulk purchases or being able to borrow money at a lower interest rate because of their larger size.

CORE