

# Unit 1

## THE NATURE OF BUSINESS

### Unit Outcomes:

*After studying this unit, you will be able to:*

- define business and business enterprises.
- distinguish between human needs and wants.
- state the importance of business enterprises.
- list the different types of business enterprises.
- state the impacts of business environments on business enterprises.
- relate business activities to real life situation.

### Introduction

Business enterprises are among the major establishments in any country that influence social and individual life. Business enterprises satisfy our needs and wants by combining resources-(material, finance, human, talent etc) and/or distributing products. Besides, business as a socio-economic activity provides an opportunity to live better by earning income by which individuals fulfill their requirements. Societies and individuals highly depend on business enterprises for their survival and hence business influences individual as well as social life.

People, wherever they live, have always need food to eat, clothes to wear and shelter to live in because these are basic things that are needed for survival. In addition to these basic needs, there are many things that people want to make their lives more comfortable or satisfying. All the enterprises that you encounter on a daily basis to obtain what you need or want are business enterprises. Retail shops which are located in many places around your localities, potter, wood works, metal works, repair shops, barber shops (where you get your haircut) and hotels are some of the few examples of business enterprises. Large enterprises like banks, insurance companies, private colleges and manufacturers of automobiles are also examples of business enterprises. Business enterprises are the engine of growth and productivity. They are key forces in the growth of a nation.

Business enterprises are major institutions in every society that greatly influence the way we live. We give value and importance to a truck driver who moves goods quickly from places where they are produced to where they are needed. Small shops make a variety of goods available at a price the buyer is willing to pay. These are only a few examples of the contributions of business enterprises for our daily life. Business enterprises are also social institutions, as they are comprised of human groups working towards goals that agree with the overall goals of a society. In large business enterprises like banks, a number of employees work together. The employees in banks are part of the society with different backgrounds. The existence of such institutions like banks brought employees together to work for one common goal.

Knowledge of business as a socio-economic activity and how it operates to fulfill needs and wants, what activities business performs is essential to productively engage in it. The purpose of this unit is to provide basic knowledge to understand business, the basic values of business enterprises and the various functions performed by them.

### Contents of the Unit

In order to achieve the above objectives, you will learn the following topics:

- Definition of business.
- Importance of business enterprises.
- Kinds of businesses.
- The business environment and how it influences business.



What do you understand by the term business? Compare your answer with the definition of business stated below.

## 1.1 What is Business?

**Business can be defined as a socio-economic activity that satisfies human needs and wants by providing goods and services for profit to maintain and improve quality of life.** The basic concepts indicated in this definition are briefly discussed here under.

### 1.1.1. Business is a Socio-Economic Activity

Business is a social activity where large number of people participate in it, individually and/or in-group. It is a group effort to create value that satisfies human

requirements. Some people engage in creating goods and services (producers); others make the created goods and services available for timely consumption (distributors); others inform the public about the availability of the goods and services, where they can be obtained and how they are to be used (advertisers). It is the totality of these efforts of different groups conducted in a coordinated manner that brings fulfillment of human requirements. As such, business is social in nature. Business is also an economic activity as it involves the use of economic resources which are scarce in nature. Because such resources are rare, they have to be used as efficiently as possible so that the maximum possible benefit can be obtained.

### 1.1.2 Business Satisfies Needs and Wants

Business is our principal means of satisfying human needs and wants. Suppose, one afternoon on your way to school, you felt hungry. If you have enough money, you head for the nearest tearoom and buy tea and bread. You begin enjoying tea and bread to satisfy hunger because the tearoom a business enterprise-sold bread and tea for you. Hence, business made it possible for you with what you need and want. But what are needs and wants?

#### 1.1.2.1 Needs

Needs are basic forces that move a person to do something. Some needs involve a person's effort to exist as a physical being. Others involve efforts to build or show ones self-esteem and relationships with others. Those needs that the individuals are forced to fulfill to survive are called **basic needs**. The need for food, clothing and shelter are examples of basic needs. They are basic because one cannot live without satisfying such needs.



*Figure. 1.1 Individuals need food for survival*



? Describe basic needs with examples and state how people in your locality strive to fulfill them.

A human being has also social needs and individual needs. **Social needs** are needs of affection and belonging to the group. At school you need friends to share ideas with. At home you need your family because they will support you. You probably think to marry. The activities that you make to form relationships with others are all examples of social needs.



**Figure. 1.2** Individuals need group and affection

**Individual needs** are needs for self-growth and self-expression. Probably as a student of the college preparatory class, you are aspiring to join colleges and universities. After completing your studies, you may think of working in large organizations. After achieving a certain state of your needs you still desire to improve yourself. The efforts that individuals make to develop themselves with the intention of improving their life styles are examples of individual needs.



**Figure. 1.3** Individuals need to grow

### 1.1.2.2 Wants

Wants are preferences for something that are learned during a person's life. For example, everyone requires drinking something when being thirsty. But some people have learned to take soft drinks to satisfy their needs of thirst instead of water; some prefer beer to soft drinks. Hence wants are preferences to certain things to satisfy needs. Human wants also take many forms as they are shaped by culture and individual personality. For example, many of us in Ethiopia may want 'injera' to

satisfy the need of eating. However, a hungry person in Kenya may want maize porridge to satisfy the need of eating. Both persons in Kenya and Ethiopia have one common thing: they need to eat. But they differ on how they satisfy their needs. Eating 'injera' or eating porridge was learned from the practices/experiences of their specific society they belong to. Wants are described in terms of objects that will satisfy needs. Needs are more basic than wants.



Differentiate needs and wants by taking examples from your locality.

As society develops and people are exposed to more objects, their wants not only expands but also shifts. This suggests that human needs and wants shift with the advance of civilization. Yesterday's demand for horses in large cities is replaced by an even greater demand for automobiles and motorcycles. Following these changes, businesses also shift towards satisfying the newly emerging needs and wants by new goods or services. Hence there will always be a wide range of human needs and wants that encourage business to operate in whatever circumstances.

People have unlimited wants but resources are limited. Each nation's or individual resources can be counted. There is no nation in the world, which possess endless resources. Countries could differ in the degree of resources they possess. Some countries could be rich in resources. But what they do possess are counted. In contrast to limited resources, human wants are unlimited. No sooner are some wants satisfied than new ones take their place. Human wants are without limit because they multiply as the population grows.

### 1.1.3 Business Provides Goods and Services



Can you explain the difference between goods and services supporting with examples. Then read the next section.

In meeting human needs and wants, business provides goods and services to individuals, groups and organizations. Goods and services are means by which people satisfy their needs and wants. A business must provide its customers, whether they are individuals or organizations, with something that they need or want. Otherwise, the business will have no sales, no income and no profit and will be forced to close its doors. Hence the provision of goods and services that satisfy some kind of need and wants of consumers is the basis for the survival of a business enterprise. But what are goods and services?



### 1.1.3.1 Goods

Goods are material objects with a typical physical form (shape) such as tables, books, the furniture that you find at your home and other items like television, radios, calculators, automobiles, etc. Goods are objects that you can feel, taste and see. Goods are classified as (I) Consumer goods and (II) Producer goods.

Before discussing consumer goods, let us briefly review what consumers are.

**Consumers** are people or individuals who buy products for their personal or family use. Consumers are made up of individuals and families. Everyone is a consumer. Each of us at least needs to buy goods for our basic necessities of life. Individual consumers are generally those persons that buy goods not for the purpose of making other goods, selling the goods or for using in an organizational setting but for individual consumption.

**I. Consumer goods** are those goods that are purchased by individuals for their personal or family use. Consumer goods usually are characterized by the level/extent of effort the individual consumer engages to obtain the goods. Based on the level of effort made, consumer goods are classified into three categories: convenience goods, shopping goods and specialty goods.

**a) Convenience goods** are goods that are bought by the consumer after little buying effort, purchased frequently, bought by habit and available in numerous shops, in most cases near to the residence of the consumer. Some of the examples of convenience goods are candies, bars of soaps, sugar and salt. Their price is comparatively low. In the process of buying these goods, the buyer will not, for example, require gathering special information as to how to use them and to buy or not to buy, go far from his/her home, etc. They are habitually known and readily available near to ones home. Further more, if one type of soap, for example, is not available, the consumer will buy another type without much thinking as one can substitute the other.



**Figure.1.4 Convenience goods shown above are widely available**

**b) Shopping goods** are consumer goods that are bought after comparing several features of the product. Their price is relatively higher than that of convenience goods. This feature requires the buyer to collect additional information to explore from the market before deciding to buy. Shopping goods are purchased infrequently and are not readily available in nearby shops as they are sold in a limited number of selected shops. Examples of shopping goods are men's suits, trousers, sweaters, furnitures, shoes, and televisions. Usually shopping goods have a higher unit price than convenience goods.



**Figure.1.5. Examples of shopping goods**

**c) Specialty goods** are goods bought by the consumer after a special buying effort ; purchased very infrequently and are sold in a few exclusive shops. No substitute will be considered for specialty goods. The consumer is looking for goods that he/she will be interested. Price is not a major consideration for specialty goods. Examples of specialty goods are fine jewelry, diamonds, prestige automobiles and expensive perfumes.



**Figure. 1.6. Specialty goods are rarely bought by consumers and are found in limited Places**



## Differentiate between convenience goods, shopping goods and specialty goods.

**Producers** are those people and organizations that convert inputs to a more useful product for users. These groups include individuals and organizations, which use hand tools or sophisticated machinery to produce goods for consumers. Producers are also those investors and organizations who supply money to initiate and sustain a business. Producers taken as a whole supply the products and services that are demanded by consumers. Examples of producers are potter, wood worker, metal worker, farmers and those enterprises that produce higher level goods like cars using sophisticated machinery.



**Figure. 1.7 An example of a producer**

**II. Producer goods** are those goods that are bought by individuals and organizations for further processing, or for use in operations, not for personal consumption. Notice that the distinction between a consumer good and a producer good is based on the purpose for which goods are purchased. For example, if you buy milk for your personal consumption, then the milk would be classified as a consumer good. However, if the producer of butter bought milk as a raw material, changed to butter, then the milk would be classified as a producer good. Thus producer goods are used to produce other goods or are consumed in the operations of a business or other organizations.

Producer goods can be classified according to how they enter the production process and according to what they cost. There are five groups:

- |                        |                  |
|------------------------|------------------|
| a) Raw materials       | d) Capital items |
| b) Component materials | e) Supplies      |
| c) Component parts     |                  |



- a) Raw Materials** are producer goods, which are bought without being processed. Raw materials enter the production process directly. Raw materials include farm products (wheat, cotton, livestock, fruits, vegetables etc) and natural products (crude oil, timber, iron ore and etc) that are converted into a useful product or service. The outputs of the raw materials usually have different shapes and sizes from the input. For example, cotton when processed would be changed to cloth. The raw sheep leather when processed would be changed to shoes or leather coats. In these instances, a cloth or a shoe has different shape and size from the cotton or leather.
- b) Component materials** are manufactured materials, which require further processing to fit into the final product. Such materials are usually referred to as semi-finished products that are already manufactured but not consumed as finished products. For example, pig iron is further processed into steel. Fiber is further processed to make clothes.
- c) Component parts** usually are not processed by the manufacturer or the manufacturer does not change the form of the component parts. Component parts enter the finished products with no further processing as when tires are fitted to automobiles. Small motors, which activate the machinery, usually are assembled without any processing or changing the form of the motors.
- d) Capital items** are producer goods, which require large investments and last for longer period of time. The machinery and buildings that producers use for manufacturing purpose are examples of capital items. Capital items are purchased after longer purchasing decisions and are used for a number of years. Capital items include two groups: Installations and accessory equipment. Installations consist of buildings, machinery, and fixed equipment like generators and large computers. Accessory equipment includes portable factory equipment and tools, which do not become part of finished goods. The price of accessory equipment is much lower than installations. Examples of accessory equipment are hand tools like hammer, office desks and fax machines. Accessory equipment has a shorter life than installations and simple aid in the production process.
- e) Supplies** are producer goods, which are consumed in the operation of manufacturing processes. Supplies include such items like lubricants, pencils, nails, brooms and etc, which will be consumed in the operation of the business process.

**Activity: 1**

Do the following

- Identify a manufacturing enterprise in your locality and report on the producer goods it uses and the final products it produces.

**?** What are services? Can you give example of services that you may need?

**1.1.3.2 Services:**

Are any activity or benefit that one party can offer to another that is essentially intangible and which does not result in the ownership of anything. Services are activities that help people or organization without directly creating a physical product. Activities such as depositing money in a bank, getting a haircut, medical treatment, watching cinema, using hotels for drinks, having clothes cleaned at a dry cleaner, getting advice from a lawyer are examples of services.



**Figure 1.8 Examples of services**

**?** List the factors that distinguish service firms from manufacturing firms. Support your discussion with examples drawn from business experiences in your vicinity.

Services have four characteristics. These are:

- |                   |                  |
|-------------------|------------------|
| a) Intangibility  | c) Variability   |
| b) Inseparability | d) Perishability |

**a) Service intangibility** means that service cannot be seen, tasted, felt, heard or smelled before it is bought or consumed. For example, you cannot describe the

actors in a movie before watching the cinema. Primarily you must get into the hall or watch movies to describe the characteristics of the actors. This may require buying a ticket in order to get into the hall. If you are sick, you may go to nearby hospitals or health centers. In this situation, the medical personnel must first examine you to be cured from the disease. Such activity primarily requires the service of the medical person. People undergoing surgery cannot see the result before the surgery. Passengers have nothing but a ticket and the promise of safe arrival to their destinations.

Because of intangibility of services, buyers usually look for tangible aspects used for the service provision to judge the quality of the service to be bought. They draw conclusions about service quality from the place, people, equipment, communication material and price that can be charged. As a student when your parents buy for you a school uniform they may choose tailors. The choice of tailors may depend on the price that can be charged, the experience of the tailor or the uniforms/suits that were made by the tailor in the past.



What is service intangibility? Provide examples for your answer based on your personal observations.

**b) Service Inseparability** means that services cannot be separated from their providers whether the providers are people or machines. If a person provides a service, then the person is part of the service. For example, when you are going to a barbershop to get your haircut, the barber is part of the activity. Though, the barber is receiving money for his/her service, he/she also is providing service of hair cutting for you. It means that the service cannot be separated from the producer since services are produced and consumed at the same time. In other word, the quality of the service is highly dependent on the service provider and the facilities the service provider uses. Taking the same example of barber, while cutting your hair, he/she is producing the service. Actually when the barber is cutting your hair you are consuming his/her service. Hence the production (hair cutting by the barber) and consumption (service given to you i.e. getting hair cut) are simultaneously done and, at the same time, the quality of the haircut depends on the experience, motivation and skill of the barber.

**c) Service variability** means that the quality of service depends on who provides them as well as when, where and how they are provided. For example, some



hotels have good names for providing better services than others. The reputations might arise from the way the workers treat the customers or the locations of the hotel. In material production, adding more or improved machines can increase productivity. In the service activity, improved productivity will depend on the workers. For example, in hospitals tools might be important. But above all the quality and the knowledge of the medical persons are more important than the tools. The tools and machines existing in the hospital can never be a substitute for the medical persons such as doctors and nurses.

**d) Service perishability** means that service cannot be stored for later sale or use. Producers of goods usually store goods for later sale. However, in services such storage would not exist. For example, in hospitals service-value exists only when the patient is there and disappeared when the patient did not show up. Physical goods are produced then stored, later sold and still later consumed. In contrast services will only exist when consumers exist and after the services are rendered.

#### 1.1.4 Business Intends to Make Private Profit

The primary goal of any business is to make profit. The hope of making private profit and of creating wealth is the main reason why businesses are started and continue to operate. Without private profit, a businessperson would not be encouraged to use his/her skill and creativity to meet consumer demands. Without private profit, investors would not take the risk of providing the capital needed for the business. Profit is the businessperson's payoff for satisfying human needs and wants. In simplest terms, profit is the amount of money left from income made by selling goods and services after all costs of producing, marketing and distributing the goods and services have been paid.

Sometimes, there is no money left over, or costs might turn out to be higher than income. When the costs are greater than the income, the business incurs a loss. The intention of a business, however, is to operate in such a way that profits will be as high as possible, consistent with social responsibility. The incentive to make money is called the profit motive. The profit motive is that which most clearly distinguishes business from other kinds of enterprises. See how profit is computed below.

**Table 1.1**  
**Profit or Loss?**

<b>Company 'A' generated revenue from sales ---</b>	<b>Birr 100,000</b>
<b>It deducts the costs for materials, labor, rent-</b>	<b><u>90,000</u></b>
<b>What is left is its profit . . . . .</b>	<b><u>10,000</u></b>
<b>Company 'B' generated revenue from sales ---</b>	<b>Birr 100,000</b>
<b>It deducts the costs for materials, labor, rent</b>	<b><u>-110,000</u></b>
<b>Company 'B' incurred a loss of . . . . .</b>	<b><u>- 10,000</u></b>

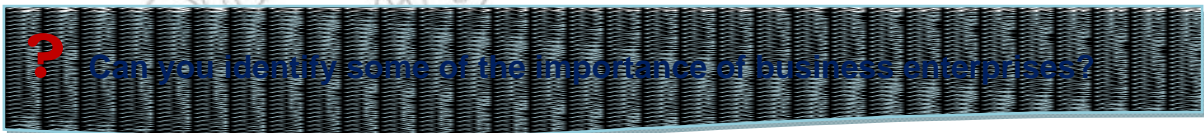
In the case of company 'A', the revenue is exceeding the cost. As a result, the company gains profit; however, in the case of company 'B', the costs are exceeding the revenue. Hence company 'B' incurs a loss.

Apart from business enterprises, there are also non-profit enterprises. Enterprises, which do not seek profit, are called nonprofit enterprises. The primary aim of such organizations is to satisfy the needs and wants of certain groups or the society at large but primarily not for making a profit. Some of the examples for non-profit organizations are hospitals, museums, and charitable organizations commonly known as NGO's, schools and colleges. The principal difference between business enterprises and non-profit enterprises is the profit motive. i.e. business enterprises have profit motives whereas non-profit organizations do not have.

**Activity: 2**

1. Define business enterprises.
2. Distinguish between goods and services.
3. Name five profit making enterprises in your locality.
4. Describe services with their special features. State what makes services different from goods with examples.

**1.2 Importance of Business Enterprises**



Apart from providing profit and other benefits to owners, as discussed in the preceding paragraphs, businesses serve important social functions. Business enterprises serve as:

1. Agents of exchange.
2. Source of income.

3. Agents of socio-cultural interaction.
4. Agent of technological advancement.
5. Source of employment.

### 1.2.1 Business Serves as an Agent of Exchange

When you buy your books from a bookshop in cash, you are exchanging money for books. This is made possible for you because there is an enterprise that sales book. The fact that certain people and group have goods that others needed and did not have or could not produce for themselves created the need for exchange. Even in early cultures, certain groups of individuals were specialized in producing tools and weapons, while groups of individuals specialized in producing household implements. Certain groups may still specialize in the production of agricultural products. In such instances, the producers of tools and weapons want to consume agricultural products. Simultaneously, the producer of agricultural products will need tools to produce agricultural products. Hence they may exchange tools for agricultural products.

With the development of society in size and complexity, groups who bring various products at a certain place to make it available for all range of people with different needs emerged. This is how trade started. We commonly refer this gradual development as an instance where merchants appeared between the producers and consumers. In today's complex society, we are surrounded by a number of merchants or businesspersons that assemble goods for convenient consumption. Because of the existence of business enterprises, we can easily exchange products. For example, the producer of shoes can easily convert the shoe to cash through selling. With the cash available, the producer can easily buy what is needed for life. This is made possible through the exchange process.

Exchange is the core concept in business. For an exchange to take place, several conditions must be satisfied. First of all, at least two parties, the buyer and seller, must participate, where each party has something of value to exchange with the other. The money that is in the pocket of the buyer is a valuable thing that the seller needs, and the product that the seller offers for sale is also a valuable thing that the buyer wants. Secondly, each party must also want to deal with the other and each must be free to accept or reject the other's offer. Finally, each party must be able to communicate and deliver the items exchanged. The buyer must exchange the money for the goods offered by the seller. These conditions simply make exchange possible.





Describe exchange as a basis for business with the conditions necessary for exchange.

When an exchange of one value for another value occurred, we say a transaction has taken place.

A transaction is a unit of measurement in exchange.

In transaction products are measured in terms of their equivalence. For example, you pay birr 10 and get a book in return. In this case the value of the book is equivalent to birr 10. When products are exchanged for money, it is a monetary transaction. Specific kinds of goods and services can also be exchanged for other goods and services. In this situation money as a medium of exchange is not involved. Trading goods for goods is bartering. In a barter transaction an axe might be exchanged for sacks of grain. A barter transaction can also involve in services. For example a lawyer may write a will for a doctor in return for a medical examination.

In ancient times when people had no money, they simply traded goods for other goods. A person who had more grain than needed exchange the surplus for fish or something the person lacked. Barter is still practiced to some extent today. For example, trading in an old car as partial payment for a new one is a common practice. Or trading sheep with goats or other livestock are some of the common practices.

Barter, however, has certain drawbacks that can be overcome by the use of money. The drawbacks of the barter system are:

- a) Absence of double coincidence of wants
- b) Absence of subdivision
- c) Difficulty of storage

**a) Absence of double coincidence of wants:** Barter requires a double coincidence of wants. For example if a farmer wants a cow and had 4 quintals of grain, he must find someone with a cow that in return need 4 quintals of grain. Such situation would not occur easily because someone that had a cow might need to exchange the cow with a horse. Money, however, overcomes these difficulties. With money, someone can buy whatever he/she wants.

**b) Absence of subdivision:** Sometimes it will be difficult to split up commodities into parts. They will lose their value if they are subdivided. For example, if

somebody wants to sell an axe and wants to buy some grain and some cloth, it is impossible to divide the axe and give it for all the products that are needed.

**c) Difficulty of storage:** Money serves as store of value. In the absence of money a person has to store his/her wealth in the form of commodities and they may not be stored for a long period of time. This is so because some commodities are perishable and some will lose their value.



Differentiate between monetary transactions and barter; state the problems associated with the barter transaction.

### 1.2.2 Business is the Source of Income

Business is the source of income for the owners and for the employees. When the business generates profit, the profit is an income for the owners. When the employees receive their salaries and wages it is an income for employees. By the income generated, owners and employees would sustain their lives. Not only business is a source of income for employees and owners, it also allows the accumulation of wealth. Wealth embraces everything that money can buy not limited to the possession of abundance of money. More specifically, wealth includes material goods, services and leisure all of which have been made available by businesses.

Business enterprises are also sources of income for governments. Business enterprises must pay tax on their profits. The taxes that will be collected from the business enterprises are the major source of income for governments. Taxes are amounts that will be collected from individuals and businesses by governments. You may think why governments would collect taxes. Governments require money to provide public services and for promoting the general well being of the society. For example, the police forces that you are encountering daily maintain peace and safety of the public. In return to the services the policemen rendered to the society, they will be paid salaries. This is one of the examples of expenses that will be incurred by governments. The governments pay such expenses by collecting taxes from individuals and organizations including business enterprises.

Governments obtain income to support their operations from variety of taxes. The most important source of revenue for the government is an income tax. An income tax is a regular payment made to a government by individuals and organizations from their income, which vary by income level. There are two types of income taxes:

Personal and business income tax. Personal income tax is paid based on how much money individuals earn from employment and/or investments. The rate of personal income taxes increases as the individual earns more money. Businesses income taxes are taxes paid by the business enterprises based on profits remaining after all costs of operating business have been deducted.

### Activity: 3

1. List the importance of business enterprises.
2. Discuss the shortcomings of barter transactions.
3. Identify a kind of barter transaction that may take place in your surroundings.

## Types of Taxes

 Why is it important to pay taxes?

In most countries, individuals pay income taxes when they earn money, consumption taxes when they spend it, property taxes when they own a home or land, and in some case estate taxes when they die.

Taxes on people's incomes play critical roles in the revenue systems of all countries. Personal income taxation is the single largest source of revenue for governments. Payroll taxes, which are used to finance social insurance programs such as social security and medicare, account for almost a large part of federal revenues. States also taxes the incomes of corporations.

State regional governments depend on sales taxes and property taxes as their main sources of funding. Regional states also tax incomes of individuals and corporations, although less heavily than the federal government.

### ***A. An Individual Income Tax, also called a Personal Income Tax***

It is a tax on a person's income. Income includes wages, salaries, and other earnings from one's occupation interest earned by savings accounts and certain type of bonds; rents (earnings from rented properties); royalties earned on sales of patented or copyrighted items, such as inventions and books; and dividends from stock. Income also includes capital gains, which are profits from the sale of stock, real estate, or investments whose value has increased over time.



Income taxation enjoys widespread support because income is considered a good indicator of an individual's ability to pay. However, income taxes are hard to administer because measuring income is often difficult. For example, some people receive part of their income "in-kind"—in the form of goods and services rather than in cash. Farmers provide field hands with food, and corporation may give employees access to company cars and free parking space. If governments tax cash income but not in-kind compensation, then people can avoid taxation by taking a higher proportion of their income as in-kind compensation.

As to the Ethiopian Negarit Gazetha of proclamation No. 286/1994/20 [286/2002 G.C] Income tax proclamation defines the applicable tax rate for monthly employment earning. The first 150 birr from employment shall be exempt from payment of income tax in all cases. Tax on income from employment over 150 birr shall be charged and collected monthly according to the following table. The percentage charge for personal income tax of Ethiopia at present is shown in table 1.2.

**Table 1.2. Percentage charge of personal income tax based on the income level In Ethiopia as an Example**

No	Monthly Income Birr	Percentage of Income Tax
1	1-150	No charge
2	151-650	10%
3	651-1400	15%
4	1401-2350	20%
5	2351-3550	25%
6	3551-5000	30%
7	5000+	35%

The computation of the income tax for the individuals is shown as follows:

Ato Biruk Worku monthly salary 2500 birr

Computation of income tax

### **Method 1**

**Earning per tax range ± tax rate = Salary income tax**

The first 150 ± 0	= 0
The next 500 i.e. (650-150) ± 10%	= 50
The next 750 i.e. (1400-650) ± 15%	= 112.50
The next 950 i.e. (2350 - 1400) ± 20%	= 190
The next 150 i.e. (2500-2350) ± 25%	= <u>37.50</u>
Total <u>2500</u>	Total salary tax <u>390.00</u>

Income after income tax = 2500- 390 = 2110 birr

**Method 2**

By using the formula table (Note that x represents Monthly Income Range)

No	Monthly Income Range	Formula
1	1 – 150	No charge
2	151 – 650	0.10 x – 15.00
3	651 – 1400	0.15 x – 47.50
4	1401 – 2350	0.20 x – 117.50
5	2351 – 3550	0.25 x – 235.00
6	3551 – 5000	0.30 x – 412.50
7	5000 +	0.35 x – 662.50

The income tax of Ato Biruk Worku would be computed as follows based on the formula table.

Ato Biruk Worku monthly salary = birr 2500

Taxable income is 2500

Income tax = (2500 ± 25%) = 625

625 - 235 = 390

Income after income tax= 2500 - 390 = birr 2110

As shown in table 1.2 above, the percentage of the personal income tax increases as one earns more. For an individual who earns 1-150 birr he/she is not required to pay an income tax. For a person who earns 151-650 he/she is required to pay 10% of income tax as shown in the table. The percentage charge of income tax is shown opposite to the income levels indicated in the table 1.2. The computation of an income tax is illustrated as follows:

Suppose W/o Shashe earns a monthly salary of 700 birr. The amount that she will pay for the income would be computed as follows. Since all individuals are exempted from the first 150birr, this amount would be deducted from the gross amount to determine the taxable amount. Accordingly, 700 – 150 = 550. Since, W/o Shashe's taxable income falls within the range of 151- 650 birr; the tax rate applied is 10% as shown in table 1.2. Thus the amount she would be charged for income tax would be 500 ±10% = birr 50 and the remaining birr 50 should be taxed as 50 u 15% = 7.5. Now, W/o Shashe is required to pay birr 57.50 for personal income tax out of her gross monthly income of birr 700.00. The computation is summarized as:

700 -150 = 550 (Taxable income)

500 ± 10% = birr 50 (Income tax)

50 ± 15% = birr 7.5 (Income tax)

700 57.5 = birr 642.5 (Income after income tax). It is also known as disposable income or take home money.

**Activity: 4**

1. Ask employees that you may know in your vicinity their salary and compute the income tax and the income after the income tax and show for correction for your instructor.
2. By taking a particular business enterprise around your locality report the types of taxes the organization pays to local authorities and the rates applied for different taxes.

***B. Corporate Income Tax***

The corporate income tax is one of the most controversial types of taxes. Although the law treats corporations as if they have an independent ability to pay a tax, many economists note that only real people—such as the shareholder who own corporations—can bear a tax burden. In addition, the corporate income tax lead to double taxation of corporate income. Income is taxed once when it is earned by the corporation, and a second time when it is paid out to shareholders in the form of dividends. Thus, corporate income faces a higher tax burden than income earned by individuals or by other types of businesses.

***C. Payroll Tax***

Whereas an income tax is levied on all source of income, a payroll tax applies only to wages and salaries. Employers automatically withhold payroll taxes from employees' wages and forward them to the government. Payroll taxes are the main sources of funding for various social insurance programs, such as those that provide benefits to the poor, elderly, unemployed, and disabled.

***D. Consumption Tax***

A consumption tax is a tax levied on sales of goods or services. The most important kinds of consumption taxes are general sales taxes, excise taxes, value-added taxes, and tariffs.

***i. General Sales Taxes***

A general sale tax impose the same tax rate on a wide variety of goods and, in some cases, services. Although sellers are legally responsible for paying sales taxes, and sellers collect sales taxes from consumers, the burden of any given sale tax is often divided between sellers and consumers. Most state exempt certain necessities from sales tax, such as basic groceries and prescription drugs. Both individuals and businesses pay sales tax.



## ii. Excise Taxes

Federal, state, and local governments levy excise taxes, which are sale taxes on specific goods or services. Excise taxes are also called elective sales taxes. Goods subject to excise taxes include tobacco products, alcoholic beverages, gasoline, and some luxury items. Excise taxes are applied either on a per unit basis, such as per package of cigarettes or per liter or gallon of gasoline, or as a fixed percentage of the sales price.

Governments sometimes levy excise taxes to pay for specific projects. For example, voters in a city might approve a tax in hotel rooms to help pay for a new convention center. Some national governments impose an excise tax on airline tickets to help pay for airport improvements. Revenues from gasoline taxes typically pay for highway construction and improvements. Excise taxes designed to limit consumption of a commodity, such as taxes on cigarettes and alcoholic beverages, are commonly known as “sin taxes.”

Another type of excise tax is the license tax. Most states require people to buy licenses to engage in certain activities, such as hunting and fishing, operating a motor vehicle, owning a business, and selling alcoholic beverages.

## iii. Value-Added Tax /VAT/

The favored form of consumption taxation is a value-added tax (VAT). In this system, the seller pays the government a percentage of the value added to goods or services at each stage of production. The value added at each stage of production is the difference between the seller’s costs for materials and the selling price. In essence, a VAT is just a general sales tax that is collected at multiple stages.

In the production of bread, for example, the farmer grows wheat and sells them to a baker, who turns them into a bread. The baker sells the bread to a restaurant owner, who sells it to a consumer. At each stage, the producer adds value to the commodity by processing it with capital (machines) and labor. The farmer, the baker, and the restaurant owner each charges their customer a VAT. However, they can each claim a credit to recover the tax they paid on purchases related to their commercial activities.

### Computations of VAT

The following examples illustrate how VAT is charged as goods move from one vendor to the next in the manufacturing, wholesale and retail chain, until they reach the final consumer.

1. Manufacturer sells to wholesales	
at VAT @ 15%	10,000
VAT	<u>1,500</u>
	Total <u>11,500</u>
2. Whole sales sells to Retailer at	
VAT @ 15%	12,000
VAT	<u>1,800</u>
	Total <u>13,800</u>
{Output Tax--input Tax}	
Birr {1,800--1,500}	
3. Retailer sells to consumer at	
VAT @ 15%	14,400
Final Price including VAT	<u>2,160</u>
	<u>16,560</u>
{Output Tax--input Tax}	
Birr {2,160-1800}	
	<u>360</u>
	Total Tax <u>2,160</u>

**iv. Tariffs**

Tariffs also called duties or customs duties are taxes levied on imported or exported goods. Import duties are considered consumption taxes because they are levied on goods to be consumed. Import duties also protect domestic industries from foreign competition by making imported goods more expensive than their domestic counter parts.

**E. Property Taxes**

In principle, a property tax is a tax on an individual's wealth--the value of all of the person's assets, both financial (such as stocks and bonds) and real (such as houses, cars, and artwork). In practice, property taxes are usually more limited. The property tax is often unpopular with homeowners. One reason is that, because homes are not sold very often, governments must levy the tax on the estimated value of the dwelling.

**F. Estate, Inheritance, and Gift Taxes**

When a person dies, the property that he or she leaves for others may be subject to tax. An estate tax is a tax on the deceased person's estate, which includes everything the person owned at the time of death--money, real estate, stock, bonds, proceeds from insurance policies, and material possessions. Most governments levy estate taxes before the deceased person's property passes to heirs, although many

governments do not impose an estate tax on property inherited by a spouse. An inheritance tax also taxes passes to heirs. The inheritors pay the tax. Estate and inheritance taxes are sometimes collectively called death taxes. A gift tax is a tax on the transfer of property between living people.

Estate and gift taxes are controversial. Proponents argue that they are useful tools for distributing wealth more equally in society and preventing the rise of powerful oligarchies. Opponents view on the other hand argue that it is a person's right to pass on property to his or her heirs, and the government has no right to interfere. If an individual has paid tax on his or her income while in the process of accumulating wealth, critics ask, why should it be taxed again when the wealth is transferred? Others argue that estate and gift taxes discourage individuals from working and saving to accumulate wealth to leave to their children. On the other hand, the presence of an estate tax might encourage people to accumulate greater wealth in order to reach a given after-tax goal.

### **G. Other Taxes**

**A poll tax**, also called a lump-sum tax or head tax, collects the same amount of money from each individual regardless of income or circumstances. Poll taxes are not widely used because their burden falls hardest on the poor.

A pollution tax is a tax levied on a company that produces air, water, or soil pollution over a certain level established by the government. The tax provides an incentive for companies to pollute less and thus reduce damage to the environment.

Note the following points:

#### **Direct Taxes are:**

- **Personal income Tax**
- **Rental tax**
- **Business Profit Tax**
- **Withholding Tax**

#### **Indirect taxes are:**

- **VAT**
- **Excise Tax**
- **Turnover Tax**

Business Income Tax in Ethiopia is currently calculated as follows: According Proclamation 286/2002 a tax is imposed on commercial, professional or vocational activity or any other activity recognized as trade by the commercial code of Ethiopia and carried on by any person for profit.



- x Taxable business income of bodies is taxable at the rate 30%.
- x Taxable business income of other taxpayers is tax in accordance with Table 1.3; is given below.

**Table 1.3**

Nº		Taxable Business income /per year/	of the tax	Deduction
01	0	1.800	Exempt Threshold	Free
02	1.801	7800	10	180.00
03	7801	16,800	15	570,00
04	16,801	28,200	20	1410,00
05	28,201	42,600	25	2520,00
06	42,601	60,000	30	4950,00
07	Over 60,000		35	7950,00

**Example 1:** Computation of business profit tax

- Business Net profit per year/taxable Income = Birr 70500,00
- Business profit Tax = /70,500,00 ±35%/-7,950.00  
=24,675-7,950  
= Birr 16,725.00

For deductible expenses of Table 1.3 see proclamation 286/02 and regulation 78/02 Article 8 C1-8.

A Tax that is imposed on the income from rental of buildings, and if the rent of building with enclosure of house and furniture the income shall be include and taxed.

The tax payable on rented houses shall be charged, levied and collected at following rate.

1. On income bodies thirty percent/30%/ of taxable income;
2. On income of persons according to the Table 1.4

**Table 1.4**

Nº	Taxable income For Rental		Deduction	
01	0	1800	Exempt threshold	
02	1801	7,801	10	180.00
03	7801	16,800	15	570.00
04	16,801	28,200	20	1410.00
05	28,201	42,600	25	2520.00
06	42,601	60,000	30	4950.00
07	over 60,000		35	7950.00

**Example 2:** Computation of Rental income Tax

Net profit per-year/Taxable income = Birr 38,000.00

Rental Income Tax = /3,8000 u25% - 2,520.00  
 = 9,500-2520  
 = Birr 6,980.00

**1.2.3 Business Serves as an Agent of Technological Advancement**

Technology is the collection of methods a society uses to provide itself with material needs and wants. It embraces all the specific ways of obtaining food, clothing, shelter, security, transportation and the other things they desire. Because of the existence of many business enterprises in any country, there will always be a technological advancement. In a primitive society, technology may mean a body of knowledge about hunting, gathering roots or knowledge of making simple tools. In today's society, technology includes a number of methods. It includes methods of discovering new things or it includes methods of converting resources into more useful form and distributing products to end-users. In these instances, the existence of millions of business enterprises tends to stimulate technological advancement by providing many centers of initiatives and source of innovation.

**1.2.4 Business serves as a Source of Employment**

One of the greatest social contributions of businesses is to provide employment. You may be surprised to know that one factory will employ many people. The establishment of Sheraton Addis created employment opportunities for many individuals. Even in very small shops, you will find that the owners are employing themselves. In today's society, jobs and careers can be among the most important paths to personal satisfaction. Useful, productive, and rewarding employment can give meaning to people's lives by providing them with a sense of purpose, a feeling of accomplishment and, outlet for creativity. In most countries unemployment is a major problem. This is also true in Ethiopian condition. This problem would be solved if a number of business enterprises exist. One way of creating employment opportunity is to be engaged in business activities through one's own self-initiative depending on one's capacity. When there are many business enterprises there will be an opportunity for many unemployed people to be employed.

**1.2.5 Business Serves as an Agent of Socio-Cultural Interaction**

Business enterprises are the major agents for the interaction of different societies. When you are buying something you may face a seller who has a different culture than you. Culture is usually defined as the total collection of beliefs and ways of living that develop within a given society.

People grow up in a particular society that shapes their beliefs and values. They absorb a worldview that defines their relationships between themselves and others. Business enterprises play a key role for the interaction of the society. For example, in large business enterprises, thousands of workers will be employed. Obviously, the workers will come from different societies. That means they differ in cultures. While their common goal is profit, they will share and interact with different cultures. Such activities allow people to interact with each other. This is made possible by the existence of business enterprises.

 Explain the contribution of business to society apart from producing profit to the owners with examples from your locality?

### 1.3. Kinds of Business

The many functions of business and the endless possibilities for carrying out the process have resulted in remarkable diversity of business enterprises. Businesses can be classified by type: Production, distribution and service. The classification of business enterprises is elaborated as follows.

#### 1.3.1 Production Enterprises

Production is the process of converting resources into a useful form suitable for consumption/usage. Enterprises that manufacture materials or goods are called **production enterprises**. The production may be on a primary (basic) level, such as mining, farming, or forestry or it may use already manufactured materials to produce higher-level goods. The term "production" is commonly used only for processes where the physical form of materials is changed. Thus manufacturing processes are production processes. Production enterprises are distinguished from other enterprises in that such enterprises are engaged in changing the physical form of materials. They add value to starting materials by reshaping, combining or transforming them.

The different production processes may be described as:

- |               |                |             |
|---------------|----------------|-------------|
| a) extractive | c) fabrication | e) assembly |
| b) analytical | d) synthesis   |             |

**a) Extractive Processes** take physical resources from the earth, sea or air for use in further manufacturing or directly for consumers. For example, pumping crude oil from the ground, digging out gold ore, growing and harvesting maize and teff, fishing, and chopping trees are all types of extraction activities. While extraction



usually provides raw materials for further manufacturing processes, some extracted products such as maize, teff, fish can be sold directly to consumers.

- b) Analytical processes** break materials down into new and more useful forms. An analytical process separates iron from iron ore. Gold is mined from gold mines. Crude oil is separated into useful components such as gasoline, heating oil and etc.
- c) Fabrication Processes** change the size or shape of materials and join them together in various ways to create new products. Fabricating may involve cutting parts from sheet metal and forging them into shape, cutting fabric and making it into clothes, cutting and shaping wood into pieces and gluing them together to make furniture. The construction industry fabricates when putting up bridges and buildings. **Fabrication** is the process of making available finished products for sale to final buyers, or it may be the process of creating component parts to be used in further manufacturing.
- d) Synthetic Processes** create new materials by chemically or physically combining and changing materials. The original materials are no longer distinguishable from the product. Plastics, for example, are synthetics made from binders such as cellulose or synthetic resin and other materials. Many fibers for clothes are made in a similar way while steel is created from iron and other substances.
- e) Assembly Processes** create products by joining together component parts without changing their shape or composition. Screwing and bolting together the proper component parts like, hubs, spokes, brake parts and so forth can make a bicycle. A new product has been created; but all of the component parts have retained their original physical forms. They have merely been attached to one another. The final manufacturing process for many goods, like automobiles assembly. Previous manufacturing processes from extraction through sub assembly have produced the component parts.



Describe the different types of production processes with examples.

All processes described above may be continuous or intermittent. **Continuous processes** run for long periods of time with few pauses or changes. For instance, Muger cement factory, St. George Brewery, and auto assembly lines usually operate continuously for months with no essential changes in their production activities.

**Intermittent processes** are suited to custom products. A custom product is made according to the customer's specifications and design. The specific product is sold only to one customer. The manufacturers of these items are called custom manufactures. Custom goods are not made until an order is placed. The customer

usually has sole freedom in determining the specifications of the product. Custom made clothing, for instance, will be cut according to the buyer's measurements and are made of materials that the buyer selects.

Intermittent processes operate for shorter periods, in batches and often only for hours, and are easier to change. Commercial printers, for instance, often use a different set-up for every job. Continuous processes produce standard products. It refers to the idea that a great quantity of the output is produced by the same specifications. Standard products are usually made in advance of sale to unknown customers. Soft drinks, for example, are made in huge quantities without the producer knowing specifically who will buy them or when the products are going to be sold.

Production processes also differ in the amounts of labor and capital they require. **Capital-intensive** processes use expensive equipment, machines and machineries extensively and are less dependent on the activities of workers. For example, electrical power generation is capital-intensive processes. It uses expensive plants and relatively few workers, compared with quantity and value of output. On the other hand in **labor-intensive processes**, more labor is used than equipments. Workers make a significant contribution to the value of output. The production of hand-carved furniture is an example. The relatively inexpensive starting materials are converted into high-priced products through the application of skill of workers. Many repair services, like automobile repair, or plumbing are labor intensive.



Distinguish between continuous and intermittent production process and capital and labor intensive processes.

### Activity: 5

Describe in writing about extractive, analytical, fabrication, synthetic and assembly processes, and the contribution of mechanization in improving production processes.

### Trends in Production Enterprises

For many years in the past, all goods that were used by human beings were made by manual labor. Gradually, mechanization replaced the human labor with machines. Mechanization is the use of machines to do work previously done by people. It has greatly reduced the number of workers needed to produce a given amount of goods. At the same time, it has greatly increased the amount of capital needed for equipment. Mechanization had an impact everywhere. The pages of books like these, for example, were once sewn together by hand. Mechanization, therefore, replaced

those hands with a binding machine and, as a consequence, dramatically increased the number of books published. Similarly, in transportation, the mighty locomotive engine replaced the collective labor of thousands of people and animals.

A modern extension of mechanization is automation. Automation is the process of performing a mechanical operation with either the minimum of human intervention or complete automatic control. Automation is a collection of methods for controlling machinery and production processes by automatic means usually with electronic equipment. In automated production, people are necessary to put the machines into operation and sometimes to monitor or regulate them and inspect their output. Moreover, the machines are automatic and they run by themselves.

An increasingly popular form of automation is robotics. This is the use of mechanical devices that duplicate the motion of the human hand. They are especially good for dirty, dull, repetitive, and, precise works. A robot is nothing more than a computer-controlled machine, which can be programmed to perform various production tasks. The distinctive part of the robot is its "hand" or "gripper", and the arm, which can make human like movements. The first applications of robots were on hot, dirty, or heavy work, which was not well suited to human-so use of robots has subsequently been expanded into a variety of production jobs, including welding, painting, fixed assembly work and materials handling. While the use of robots can sometimes be justified by reduction of direct labor, they provide many more benefits, including flexibility to redesign parts, 24 - hour operation, performance of hazardous tasks, and more uniform quality. Robots are not mechanical people; they are part of an integrated production process.



**Figure 1-9 Robots**



### 1.3.2 Distribution Enterprises

When markets were small, producers used to sell their products directly to final consumers. As markets grew in size and in number the distance between the producers and consumers increased. As a result, a system of middlemen evolved between producers and the final consumers. Distribution enterprises are business enterprises involved in moving goods from their point of production to their point of consumption. The distribution enterprises fall into two major categories.

- (i) Intermediaries
- (ii) Physical distribution

#### 1.3.2.1 Intermediaries

Intermediaries are business enterprises that serve as a link between producers and consumers and perform the marketing functions of distributing, storing and selling of goods in return for discounts from producer or potential profit from mark ups when they resale goods. The intermediaries perform an indispensable service for today's businesses. For example if the manufacturer of shoes in Addis Ababa wants to sell his/her products all over the country by owning his/her own outlets; the manufacturer probably could not profitably sell the products individually. The solution to this problem for the manufacturer is to sell to intermediaries.

Depending on the business functions, intermediaries are classified as follows:

- a) Retailer
- b) Wholesaler
- c) Agents
- d) Brokers

The intermediaries that consumers know best are retailers. A retailer is an intermediary that directly sells the products to consumers. **A retailer** is a seller who deals directly with consumers. Our neighborhood grocery is a retailer. The baker, druggist, the service stations where you buy gasoline for the family are some of the retailers that you encounter on daily basis.

In some cases, retailers do obtain their merchandises directly from those that make or grow them. For example, when retailers buy farm products from farmers. A **wholesaler** is a business firm that buys goods in large quantity from different manufacturers and re-sale them in smaller lots. One wholesaler, for example, might purchase one thousand jackets from one or more manufacturers and sell them in turn to several retailers. Most wholesalers specialize; that is, they handle just one line of merchandise, such as food, clothing or drugs.

Now imagine a large farm enterprise that could supply ten or more retailers with fruits and vegetables. Rather than taking time to find many retailers who are willing to buy the products, the enterprise sells the entire crop to a wholesaler. Then it becomes the wholesaler's job to find retail groups who will buy the farmer's fruits and vegetables. In this situation, the wholesaler simplified the marketing job that will be performed by the manufacturers.

**Agents** are firms that act on behalf of the manufacturers. They are business enterprises that do not actually purchase the goods they sell. Agents do not take title to good; they perform mainly a distributive and market development functions. The ownership of the products remains to the manufacturers but agents sell the products and receive a commission for the services they rendered. For example, Ambo Mineral Water Factory has agents in different regions.

**Brokers** bring buyers and sellers together and assist in negotiation. The parties hiring them pay brokers. They neither carry inventory, get involved in financing nor assume risk of operating a business. Their main function is to aid in buying and selling and for these services they earn a commission.

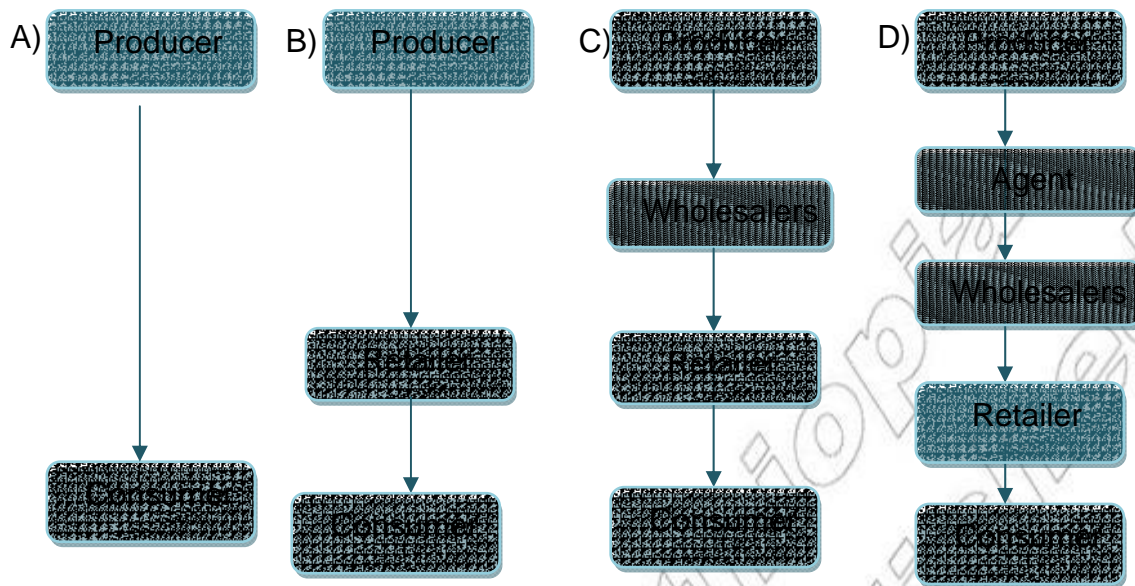
### **Distribution Channels**

Distribution Channel, also known as a trade channel or marketing channel, is the sequence of business enterprises through which a product passes on its way from producer to the final buyer.

The number of channel levels involved can describe channel of distribution. Each layer of middlemen that perform some work in bringing the product and its ownership closer to the final buyer is a channel level.

The most common channel for distributing consumer goods is the traditional path from manufacturer to wholesaler to retailers and then to consumers. This is called indirect distribution because intermediaries move the goods to consumer not the producer. Some companies use direct distribution channels, selling their products to ultimate buyers without the involvement of intermediaries. For example, when a bakery directly sell the bread to the buyers, it will be a direct distribution. In direct distribution, the consumer directly buys the goods from the producer. In this instance there is no intermediary involved between the producer and the consumer.

The processes by which goods make their way from producer to consumer are described with the following diagrams.



**Figure 1-10 Distribution Channels**

In diagram 'A' shown above, consumers directly buy products from the producer. For example, when you buy bread directly from a bakery, it takes the form of the distribution channel shown in diagram 'A'; that means there is no intermediary involved. In diagram 'B', one intermediary, the retailer is in between the consumers and the producers. Such instance occurs when the merchants buy cereals from farmers and directly sell to consumers. As shown in diagram 'C', two intermediaries, the wholesalers and retailers are involved. In this case wholesalers buy in large quantity from producers and resale it to retailers and the retailers sell to the consumers. Most of the goods that we consume take this channel. In diagram 'D', an agent is involved in addition to intermediaries described in channel "C". For example soft drink companies have agents in different regions. The agent sells to the wholesalers, the wholesalers sell to retailers and retailers to final consumers.

### 1.3.2.2 Physical Distribution

Whatever channels a manufacturer chooses, there is still a decision to be made about how to actually place the goods physically at a place where they are needed and in proper condition without delay. The distributor must resolve the practical but sometimes difficult questions of choosing the appropriate mode of distribution, i.e. appropriate physical distribution decision.



Physical distribution encompasses all the activities required to move products physically by carrying them from the producer to the consumer. Physical distribution is concerned with the movement of goods from the place they are produced (from the producer) to the place they are to be consumed (the consumer). In doing so there are a variety of options to transport the products.

? Distinguish between channel of distribution and physical distribution.

The main means of transportations are grouped as the following:-

- |                   |                         |             |
|-------------------|-------------------------|-------------|
| a) Road transport | c) Air transportation   | e) Pipeline |
| b) Rail road's    | d) Water transportation |             |

**A) Road transports:** are the most frequently used forms of transportation. Road transport includes animal transport such as mules, donkeys and horses and transportation on vehicles such as trucks and buses. Domestic animals like donkey, horses, mules and camels are widely used in Ethiopia to transport goods and/or people from place to place. Road transport had advantages of other mode of transportation for two reasons.

- i) They are good to offer door-to-door delivery from the manufacturer to the customer without intermediate unloading
- ii) They operate on public high ways that do not require an expensive terminal or right off way as airlines and railroads do.

The main drawback of trucks is that they cannot carry all types of cargo.

**B) Railroad:** involves the use of trains that carry larger amount of goods usually for long distance. They can carry heavier and more diversified cargoes. They can move long distances without interruption. But they have one major disadvantage: They can seldom deliver directly to the customer, but usually depend on trucking companies to make the final delivery to the final destination. For example, the main railway route in Ethiopia is the railway from Djibouti to Addis Ababa. The Addis Ababa -Djibouti railroad covers a distance of 784 Km.



**Figure 1.11 Rail Transport**

**C) Airplanes:** are the fastest forms of transportation. Planes can carry only certain types of cargo because of size and shape limitations. Furthermore, planes are the least dependable and most expensive forms of transportation. But despite its limitations, air transport has become absolutely essential for certain industries. Speedy air shipment sometimes saves overall distribution costs by reducing the need for storage and insurance. The most popular organization, which works on air transport in Ethiopia, is the Ethiopian Airlines founded in 1946 G.C. EAL gives both domestic and international services.



**Figure 1.12 Air Transport**

**D) Water transportation:** water transport involves the use of ship of various kinds to transport goods from place to place. Water transport is the cheapest form of transportation. Thus, it is widely used for such low-cost bulk items as oil, coal,

ore and cotton. However, some of the disadvantage of shipping makes it unsuitable for most businesses. Ships are slow, and service to any given location is infrequent. Furthermore, another form of transportation is usually needed to complete delivery. For example, to transport products from port of Djibouti to Addis Ababa requires either trucks or air transport. Shipment by water is not a common practice in many parts of Ethiopia because there is no as such a well developed and convenient water transportation or the rivers are not used for water transportation. However, in some parts of the country, rivers like Omo river and lake Tana are in use for water transportation.



**Figure 1-13 Water transportation**

**E) Pipelines:** are used almost exclusively to transport liquids and gases, and are of little use to manufacturers of other types of goods. Pipelines do provide dependable, continuous delivery for oil and natural gas. For example, a pipeline can be used to transport oil deposits from Sudan to Ethiopia.



**Figure 1.14 Pipe lines**





State the advantages and disadvantages of the mode of transportations.

### 1.3.3 Service Enterprises

Service enterprises are firms that provide services without creating or distributing goods. The communication industries, including the press, radio and television, the telecommunications systems are examples of service industry. Services to individual consumers include repair and maintenance, hotels and restaurants, barbers and hairdressers, private educators, doctors and hospitals. Financial institutions such as banks and insurance companies also provide services and are classified as service enterprises. Service firms can be classified as follows:

- |                      |  |
|----------------------|--|
| a) Business services | d) Entertainment and recreation services |
| b) Personal services | e) Hotels                                |
| c) Repair shops      |  |

#### a. Business Services

Are firms that render service to other business organizations. Examples include accounting firms, advertising agencies, public relation counselors, private employment agencies, blue print services, management consultants, etc.

#### b. Personal Services

In the personal services group are found barber and beauty shops, shoeshine, laundries, photographic studios, travel agencies, private colleges, etc.

#### c. Repair Services

Include automobile repair, shoe repair, furniture repair, electrical repair, black smith shops, etc.

#### d. Entertainment and Recreation Services

Are businesses that offer entertainment and recreations. These include gymnasiums, swimming pools, theaters and cinema, orchestras and the like.

#### e. Hotels

Hotels are firms that provide food, drinks and pension services. Hotels are large establishments compared to most of the other groups in Ethiopia.

Service industries vary greatly. The government sector offers services through legal courts, employment agencies, hospitals, loan agencies, military services, police and fire departments, postal service, regulatory agencies and schools. A large part of business enterprises also offers services through banks, hotels, insurance companies, consulting firms, medical and law practices, entertainment companies, real estate firms, advertising and research agencies. Some service businesses are large. There are also thousands of small service providers.

One of the major ways a service firm can differentiate itself is by delivering consistently higher quality service than its competitors do. The service providers need to identify the expectations of target customers concerning service quality. Unfortunately, service quality is harder to define and judge than product quality. Whatever the level of service provided, it is important that the service provider clearly defines and communicates that level so that its employees know what they must deliver and customers know what they will get. Unlike manufacturers who can adjust their machinery and inputs until everything is perfect, service quality always vary depending on the interactions between employees and customers.

#### 1.4. Business Environment

 Can you define an environment? How it relates to business operations?

The nature of the interaction between a business and its environment will be easier to understand if the concept of a system is examined. A system is a group of related parts that work together in an organized way for some specific purpose or purposes. An Individual business firm is a system. It has related parts: management, production workers, machinery and the physical plant. The parts are organized into a system so that they can work together to convert resources into valuable end products.

Just as the production department is a working part of an individual business firm, the individual firm is itself a working part of an industry. **An industry** is viewed as a collection of related businesses that all work together to supply the total demand for a particular kind of good or service. For example, a small shoe manufacturing firm produces particular types of shoes. In turn, all shoe manufacturers work together to supply shoes to the market for shoes using common materials and methods, exploiting new research findings, supporting suppliers and selling to the same

general market. They also influence one another through competition, quality, price setting, etc. Based on our example, a small shoe manufacturer is an individual firm where as all shoe manufacturing firms collectively are called the shoe industry.

A business environment is the collection of factors outside and inside the business system that influence the activities of business. The environment determines what a business can do and as such has a shaping and channeling influence on its development. Business environment also influences business enterprise decisions and ultimately the internal structure and process of business organization. Business environments interact with and influence business at every level.

Business environments are classified as **internal** and **external** environment.

### ***The internal business environments***

The internal business environments consists the following elements.

- i. The market
- ii. Suppliers
- iii. Marketing intermediaries

### ***The external business environments***

The external (macro) business environments are composed of forces outside and beyond the immediate control of the business firm. It includes the following forces.

- |                                 |                               |
|---------------------------------|-------------------------------|
| I. Economic environment         | IV. Physical environment      |
| II. Legal environments          | V. Technological environment. |
| III. Socio-cultural environment |                               |

The impacts of these environments on business are discussed as follows:

## **I. The Economic Environment**

The economic environment sets the basic rules by which a business operates. The economic environment consists of factors that affect a consumer's purchasing power and spending patterns. The economic environment affects the way firms and the whole economy use resources. The economic environment can and does change rapidly. The effects can be far reaching and require challenges in business activities. Even a well-planned business firm may fail if the country goes through a rapid business decline.



The three aspects of the economic environment of business enterprises deserving special consideration are: The global economy, the business cycle, and the economic system

### a. The Global Economy

Though the economic environment varies from one country to another, economies around the world are linked and are very much interdependent. The changes in one country's economy affect the economy of others. One reason for this is that the amount of international trade is increasing.

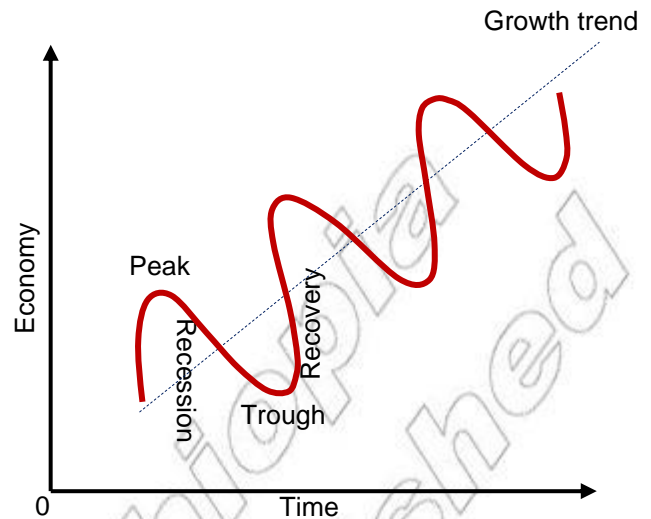
A change in the exchange rate-the worth of one country's money in terms of another country's money- has a great impact on international trade. Business enterprises are not safe from the forces of changes in exchange rate just because their firms are not involved in foreign trade. New competition arises in a domestic market, as foreign products gain a competitive edge with lower prices.

Changes in price and quantity of some products would affect the activities of the entire businesses existing in a given country. For example, the change in price and quantity supply of petroleum products would affect the whole businesses of a country. When the price of petroleum products increases the price that would be charged by business enterprises for their goods and services also increases because they use oil products as a major source of energy. Hence, the global economic environment has a direct impact on the activities of national or local business enterprises.

### b. Business Cycle

The term **business cycle** (or **economic cycle**) refers to economy-wide **fluctuations** in production or economic activity over several months or years. These fluctuations occur around a long-term growth trend, and typically involve shifts over time between periods of relatively rapid economic growth, and periods of relative stagnation or decline (contraction). These fluctuations are often measured using the growth rate of **real gross domestic product (RGDP)**. Despite being termed **cycles**, most of these fluctuations in economic activity do not follow a mechanical or predictable periodic pattern.

A business cycle consists of four unique components, each reflecting differing levels of economic activity and the subsequent circumstances occurring during each respective stage. An **expansion** or **recovery** is where the economy is experiencing positive and increasing economic output. Employment tends to increase (unemployment falls) and there is upward pressure placed on prices (inflation rises) as output rises. A **peak** or **boom** is reached when the economy has produced the greatest amount of output. At this point employment is generally at or near its highest level (unemployment is at its lowest level: usually below the full employment rate of approximately 5%) and prices tend to rise more rapidly (inflation accelerates). Following the peak is a **recession**, or **contraction**. During this phase output actually decreases (the rate of growth becomes negative); unemployment begins to rise and the inflationary pressure on prices fades. The low point of the cycle occurs next. This is known as a **trough** or **depressions** and unemployment tends to be at its peak and production at its low point. There is very little upward pressure on prices and in some cases there is downward pressure on prices (deflation).



**Figure 1.15 Business cycle**

### c. The Economic System

The economic system includes the basic economic rules that a given country follows in order to operate the business activities. In Ethiopia, the economic setting is guided by free market economic system. Businesses function in an environment where entrepreneurs are free to risk capital with the hope of creating profits and where a free market has the ultimate control over business decisions. One distinguishing mark of a free market economic system is that it permits individuals to own property of almost any kind. Anything owned by an individual is a private property.

When people are free to choose their own lines of business, some business persons make similar choices. This naturally leads to competition. Enterprises producing similar goods or services for their customer compete with one another in some way. One way is to sell at a lower price. This is known as price competition; the producer

who charges more than the competitors may be at a disadvantage. This kind of competition benefits consumers as it holds prices down.

Producers also engage in product competition. That is, each producer tries to make its products better than competing products so that it can get much profit. This kind of rivalry encourages producers to improve their existing products, develop new ones and improve their production system through the use of better technologies. For the consumer, of course, this means not only better goods and services, but also a greater variety as well.

Unlike the prevailing free market system, Ethiopia was governed by command economy system almost for two decades. In this type of economic system, the government controlled the majority of the economic activities. The major production and distribution industries were owned and operated by the government. Government assigned officials directly manage some or all of the extraction of raw materials, manufacturing, communications and transportation. Government also plays a heavy regulative role in all other business activities. Even if limited amount of private profit was available to small businesses, most of the profit centers in government hands through heavy taxation. State planners make decisions centrally about what goods and services will be available rather than by the free play of market forces. Such economic system does not encourage entrepreneurs the desire to risk their capital in order to generate profit. However, the free-market system as is described above encourages entrepreneurs to risk their capital to own businesses.

### Activity: 6

× Discuss the impact of economic environment on business operations.

## II. Legal Environment



Can you identify some of the laws governing business operations?

The legal environment is shaped by the interaction between businesses and government. The legal environments are the constraints on decision making that result from the legal and otherwise governing parameters within which the firm must operate. For example, the Federal and Regional governments would set laws that govern how business undertakings operate. Well-conceived regulations can encourage competition and ensure fair markets for goods and services. Thus, governments develop public policy to guide commerce, sets law and regulation that limit business for the good of society as a whole. Almost every business activity is subject to a wide range of laws and regulations.



Legislation affecting business has increased steadily over the years. Legislations have been enacted for a number of reasons. The first is to ensure the existence of free and fair competition among companies. By so doing, companies are protected from each other. Although business executives may praise competition, they sometimes try to neutralize it when it threatens them. So laws are passed to define and prevent unfair competition. The second purpose of government regulation is to protect consumers from unfair business practices. Some firms, if left alone would make poor products, deceive the public in their advertising, packaging and pricing.

The third purpose of government regulation is to protect the interest of society against unrestrained business behavior. Profitable business activity does not always create a better quality of life. Regulation arises to ensure that firms take responsibility for the social costs of their production or products.

### ➤ Business Law

Business law is concerned with any segment of the legal system that provides for a smooth and orderly flow of business transactions and the settlement of any disputes that may arise over these transactions.

Any business, large or small, faces the possibility of being on the initiating or receiving end of a lawsuit or some other legal action. Some useful laws that people in business should be aware of are: the law of contract, law of sales, the law of agency, the law of negotiable instruments, the law of warrants and product liability, the law of trademarks, copy rights and patents, and the law of bankruptcy.

**Law of contracts:** A contract is a voluntary agreement between two or more parties to do or not to do something. Contracts are basic to business operations because practically every business transaction involves agreements between people. For a valid contract to exist, the following requirements must be met:

- 1. Voluntary agreement:** A contract must be voluntary where there is a mutual consent between the parties. The buyer without being forced must accept a genuine offer unconditionally.
- 2. Competent contracting parties:** Contracts with parties who are under legal age, insane, seriously intoxicated, or otherwise unable to understand the nature of the transaction are typically unenforceable.
- 3. Legal act:** The subject of the agreement must not be in conflict with public policy, such as a contract to sell an illegal product.
- 4. Consideration:** Something of value, or consideration, must be received by the seller in exchange of what it gave to the buyer.

**5. Form of contract:** Contracts may be written or oral. Some contracts must be in written form to be enforceable. The existence of an oral contract must be demonstrated in some way; otherwise it may prove difficult to establish.

**Law of Sales:** Governments protect private property. Property may be real property, possessions with a long-term attachment such as buildings, personal property such as automobiles, machinery and furniture.

An important aspect of protecting property ownership is defining the terms and procedures by which control passes from one owner to another. Real property may be transferred by deed or lease. A deed actually transfers ownership to a new owner. In this case a buyer buys a property such as cars or mules on cash or on credit basis but has a full right on the property for an indefinite period of time. A lease gives temporary control of real property. This is an instance where the buyer leases land for specified period of time. The control would only exist on the time span stated on the agreement.

**Law of Agency:** An agent is a person or company authorized to carry out business and enter into agreements on behalf of another person or company called the principal. This relationship exists when executives, purchasing agents, sales representatives, and others act on behalf of their employing company. For example, your school principal acts on behalf of the Ministry of Education that assigned him/her to manage the schools affairs. An agent may also be an outside third party especially skilled at handling certain kinds of business activities. Lawyers often act as agents. The agent is obliged to work for the benefit of the principal and to follow his or her instructions while the principal is required to compensate the agent for his or her performance.



State the conditions for a legally binding contract between a buyer and seller.

**Law of Negotiable instruments:** Important legal financial contracts employ the use of negotiable instruments, which are written documents that states currency in business transactions. The best-known negotiable instruments are checks. The law specifies a negotiable instrument must have the characters in order to be transferable to a new owner, that is, to circulate much like cash. It must, for example, be written and properly signed. It must contain an unconditional promise to pay" either on demand or at a definite future date.

**Law of Warranties and Product Liability:** A warranty is a legal assurance that goods or services being sold have certain characteristics. An express warranty is a

statement, often in writing, made by the seller that the property being sold is of a specified quality and type. Express warranties often state that the seller will repair any defects or replace the merchandise if defects are found. For example some companies offer a guarantee up to one year to give maintenance services when the buyer buys such products like radio, house furniture, equipment etc. An implied warranty accompanies most sales as a standard part of law, even when the seller does not actually express it. The main provisions of an implied warranty are that:

- (a) The buyer is receiving ownership of the property and that the seller is authorized to sell and
- (b) That the goods are what they were represented to be and can be used for their intended purpose.

For example when a buyer buys a trouser, he/she immediately receives the title of ownership over the product. When the seller packs the product, it should be a product on which both the parties are agreed upon. That is, it should be a trouser not other product.

***The Law of Trademarks, Copyrights and Patents:*** As a consumer, all of us are exposed to trade marks daily. They are practically on every product we use. If you are turning the first page of the book you will find ©. This is a symbol for a copyright. When a producer invents new things he/she has a patent right.

By its legal definition, a trademark distinguishes goods supplied by a particular manufacturer or merchant from similar goods manufactured or sold by others. It helps consumers to choose between different products or services. For this reason, the entire law of trademarks depends upon how consumers perceive them. A trademark is any word, name, symbol or device used to distinguish the product of one manufacturer from those made by others. For example, Pepsi Cola or Miranda is trademark for Moha Soft Drinks Company.

When a trademark owner sues for infringement, two things are accomplished. First, the monetary interest of the trademark owner is protected from unfair competition. Second, the public is also protected from being deceived or misled.



Copyrights are somewhat similar to trade marks in that they provide a legal means of protecting one's ownership. Copyright protects property created by the mind. The most commonly eligible copy right properties are literary, musical and dramatic, pictorial, graphic, sculptures, and cartographic works, motion pictures and sound recordings. For example, Dr. Tilahun Gessese has a copy right over his musical works. This means, no one is allowed to sing or record and sell the musical works of Tilahun without his permission.

A copyright gives its owner the exclusive right to reproduce (copy), sell, or adapt the work he or she has created. For example Kibour Dr. Haddis Alemayehu has an exclusive right over his book- Fiker Eskemekabir. Patents protect the invention or discovery of a new and useful process, an article of manufacture, a machine, a chemical substance, or an improvement on any of these. Patents give the owners exclusive rights to make and sell a patented product or to use a patented process for a specific period of time usually not less than 5 years depending on the invention. For example, if a person produces a machine that was not known before (invention) he/she has a patent right over the new machinery for a period of time.

When other persons or companies produce or sell patented product or process without permission, which is called patent infringement , they are violating the patent law and are sued for damages. Like copyright, no one is allowed to make and sell the invention without the consent of the inventor (the patent owner). However, to have a patent on a certain invention, a product must consist of an idea or process not known before. It must be a discovery as distinguished from mere mechanical skill or knowledge.

**The Law of Bankruptcy:** Bankruptcy laws are intended to protect as fully as possible both a company and person with no enough money to pay debts to creditors. Bankruptcy law is a legal procedure by which a court divides up the remaining assets of an insolvent person or company among the people and organizations to which money is owed. Bankruptcy law is a way of protecting someone who is in severe financial distress because of debt to get a new start.

When bankruptcy law is declared, nearly all of the assets of the owner are eventually sold for cash. The proceeds are used to pay court costs and other costs, unpaid employee wages up to a maximum limit of each worker, taxes and secured loans. If any money is left after these charges, it is divided among creditors proportional to the total debt each is owed. The creditors then have no further claims.



**Distinguish between trademarks, patent and copyright with examples.**

### III. The Socio-Cultural Environment



What is your culture? How does it affect your shopping habit?

The socio-cultural environment is made up of institutions and other forces that affect society's basic values, perceptions, preferences, and behaviors. People grew up in a particular society that shapes their basic beliefs and values. They absorb a worldview that defines their relationships to themselves and others. All the activities of business enterprises are governed by socio-cultural environment. The products produced and the advertisements made by business enterprises should reflect the norms respected by the given society. The following socio-cultural characteristics can affect business enterprises' decision-making practices.

#### a. Cultural Values and Beliefs

People in a given society hold many beliefs and values. Their core beliefs and values have a high degree of persistence. Core values and beliefs are passed on from parents to children and are reinforced by schools, religious institutions, business and government. For example, getting married could be an example of core belief for the Ethiopian society. Secondary values and beliefs are more open to change. Believing in marriage is a core belief; believing that people should get married early in life is a secondary belief. Business enterprises have some chances of changing secondary values, but little chance of changing core values.

Although core values are fairly persistent, cultural swings do take place through time. Consider the impact of popular music groups, movie personalities, and other celebrities on young people's hair styling, clothing and other norms. Business enterprises should predict cultural shifts in order to spot new opportunities or threats. Opportunities are circumstances that favor businesses organizations to grow. For example, conducive business policies could be an example for opportunities. Threats are also external forces but have a negative impact on the activity of the business. For example war between countries could be a threat for business organizations.

#### b. People's Views

People vary in their emphasis on serving themselves and serving others. Some people seek personal pleasure, fun and change. Others seek self-realization through religion, recreation or the pursuit of careers or other life goals. People use goods and services

as a means of self-expression and buy products that match their personal view. People also vary in their attitudes toward corporations, government agencies, trade unions, universities and organizations. By and large, people are willing to work for or want to develop business type relationships with reputable organizations. This suggests that business enterprises need to find ways to win consumers' confidence. They need to carefully assess their advertising communications to make sure that their messages are honest. Also, they need to review their various activities, policies, and regulations to make sure that they are doing their job as "good corporate citizens". Business enterprises should strive to build positive image through good public relations. People's orientation to consumption patterns, level of savings and attitude toward the market place affects the activities of business enterprises. Business policies should reflect the need to consider the interests of consumers and of society as well as those of businesses. If the business enterprises ignore the values, which are respected by the society, they cannot survive for longer period. Business enterprise owners should be keen enough to identify the basic values and beliefs of the society they are operating and sense the cultural shifts that are taking place and adjust their operations accordingly.

Of course, some beliefs and values adopted by a certain cultural group may be contrary to the belief of the business owners. Business owners and managers must use tact and imagination in handling such cultural differences.

### Activity: 7

x Discuss the impact of cultural environment on business operation.

## IV. Physical Environment



Can you identify the impact of physical environment on business operations?

The interdependence of a business and its various environments is further demonstrated by its relationship with the physical natural environment. The physical environment of business involves the relationship of business with nature. It is linked with natural resources like minerals, source of energy, climate, ecology, etc that are needed as inputs by business enterprises or that are affected by their activities.

Many of the resources used to create products come from the physical environment: From the land and the sea. The use and preservation of these resources is a legitimate concern of any economic system, of a government, and of the entire society. Business enterprises should be aware of three trends in the physical



environment:

- a) Shortage of raw materials
- b) Energy supply
- c) Environmental pollution

**a) Shortages of Raw Materials:** Minerals, fresh air and water may seem to be infinite resources. However, this is not the case. Water shortage is already a big problem in some parts of Ethiopia. Renewable resources such as forests are not found as they were in the past. Deforestation has caused shortage of timber-raw material for wood products- and degradation of the soil and once fertile lands have been changed to deserts. Companies in a forestry business are required to reforest in order to protect the soil and to ensure enough wood supplies to meet future demand. Food supply is a major problem. In order to overcome the shortage of food supply business enterprises engaged in food processing business must find alternative natural resources rather than merely relying on rainwater which is not dependable at all. For example, irrigation and improved farming systems are one among many ways to overcome shortage of food supply.

Nonrenewable resources, such as oil, iron ore, and salt have recently posed a serious problem. These natural resources are dwindling in time as a result of which firms making products that require these increasingly scarce resources face substantial cost increases to extract the materials. Business organizations are forced to engage in research and development and in exploration for new sources of materials to survive.

**b) Energy supply:** All production requires energy. Manufacturing, transportation, farming, mining, communications, and other business activities are impossible without a reliable source of power. Over the years, energy in Ethiopia has become more and more dependent on petroleum products like oil and natural gas. Having to rely on oil produced in other countries is a serious problem for the country's development. Obviously we need to reduce our dependence on foreign supply. While the energy shortage is a severe challenge, it can also be seen as an ample opportunity for businesses to supply an enormous market for alternative energy sources. These alternatives have to be found, so capital should be risked to search oil and natural gas all over the country. The effort to make use of solar energy as an alternative source of energy is an example of the initiative of business organizations.

**c) Environmental Pollution:** The effort to solve the shortage of energy and raw materials has to be evaluated in terms of its potential effect on the environment. It is true to say that business enterprises have caused damage to natural

environments. Consider the disposal of chemical wastes in the soil and food supply and the littering of the environment with plastics and other packaging materials. The toxic elements that came out from heavy industries, automobiles, aircrafts, etc have greatly contributed towards air pollution. Efforts to safeguard the environment should therefore be one of the responsibilities of business enterprises. Not all-environmental pollution is caused by businesses. Municipal organizations with inadequate sewerage treatment and trash disposal systems, inadequate sanitation programs, etc can also be mentioned as causes of environmental pollution. However, it has become important to consider all of the possible results of business decisions on the ecology. Ecology is the science that studies the interaction between living organisms and their environment. Ecologists view the natural world as a complex, interrelated system in which the actions and behavior of every part affect every other part. Business enterprises must review the consequences of their actions on ecology and take appropriate measures to preserve it for better life.

## V. Technological Environment

Technology is defined as all the tools and ideas available for extending the natural, physical and mental reach of humankind. Technology is the application of organized knowledge to create new and better things, identify and solve problems in our society. The technological environment is the most dynamic force that shapes the destiny of business enterprises. Every new technology replaces an older technology. For example, computers replaced typewriters. When old business enterprises ignore new technologies, their existence will be threatened, as they cannot compete in the market. New technologies create new markets and opportunities. Technology comes into being through the innovation process- the systematic development and practical application of a new idea. A great deal of time-consuming work is necessary to develop a new idea into marketable goods or services. A better understanding of the innovation process can help to improve business enterprise chances of turning new ideas into profitable goods and services.

The innovation process has three steps. The first step is the conceptualization step when a new idea comes in the mind of someone. Development of a working prototype is the second step called product technology. This involves actually creating a product that will work as intended. The third and final step is developing a production process to create a profitable quantity-quality-price relationship. This third step is labeled as production technology. Successful innovation depends on the right combination of new ideas, product technology and production technology. A

missing or deficient step can ruin the innovation process.

In the age of increased global competition for technology leadership, pressure on business enterprises to provide society with innovative goods and services will remain high.

### ***The Internal Business Environments***

The internal environment consists of forces that are part of an organization's marketing process but are external to the organization. These micro environmental forces include the organization's customers, its producer-suppliers, its marketing intermediaries and competitors. The organization is capable of exerting more influence over these than forces in the macro environment (External environment).

The internal (micro) business environment includes the following.

#### **1. Customers**

Organizations closely monitor their customer markets in order to adjust to changing tastes and preferences. A customer is people or organizations with wants to satisfy, money to spend, and the willingness to spend it. Each target customer has distinct needs, which need to be monitored. It is imperative for an organization to know their customers, how to reach them and when customers' needs change in order to adjust its marketing efforts accordingly. The market is the focal point for all customer decisions in an organization.

#### **2. Suppliers**

Suppliers are organizations and individuals that provide the resources needed to produce goods and services. They are critical to an organization's marketing success and an important link in its value delivery system.

#### **3. Marketing Intermediaries**

Like suppliers, marketing intermediaries are an important part of the system used to deliver value to customers. Marketing intermediaries are independent organizations that aid in the flow of products from the marketing organization to its markets. The intermediaries between an organization and its markets constitute a channel of distribution. These include middlemen (wholesalers and retailers who buy and resell merchandise). Physical distribution firms help the organization to stock and move products from their points of origin to their destinations. Warehouses store and protect the goods before they move to the next destination. Marketing service agencies help the organization target and promote its products and include marketing research firms, advertising agencies, and media firms. Financial intermediaries help finance transactions and insure against risks and include banks, credit unions, and insurance companies.



## Summary

- x Business is defined as all the activities that satisfies the needs and wants by providing goods and services for profit to maintain and improve our quality of life.
- x A human need is a state of felt deprivation. Human beings have many complex needs. These include basic physical needs like food, clothing and shelter, social needs for belonging and affection and individual needs for knowledge and self-expression.
- x Human wants are the form taken to satisfy human needs that are shaped by culture, attitudes and personality.
- x Human needs and wants are unlimited but resources are limited.
- x Goods are material objects, which have a physical substance. Goods are classified as producer goods and consumer goods. Consumer goods are bought and used by individuals and families without any further processing. Producer goods are used to make other products or are consumed in the operations of a business or institution.
- x The primary goal of business is to make profit. The desire of making profit and of creating more personal wealth is the main reason why businesses are started and continue to operate.
- x Business in addition to providing goods and services also serves as agents of exchange, sources of income, agents of social-cultural interaction, agents of technological advancement and sources of employment. As it has made trade possible, increased quality of life, bring people with diversified background to work together and accelerated improvements in technology.
- x The many functions of business and the possibilities for carrying out the process have resulted in diversity of business enterprises. Business enterprises are classified as production (manufacturing), distribution and service enterprises. Production enterprises include extractive processes, analytical processes, fabrication processes, synthetic processes and assembly processes. Distribution enterprises are business enterprises involved in moving goods from the point of production to the point of consumption. The distribution enterprises are intermediaries (channel of distribution) and transportation firms. Service enterprises can be classified as business services, personal services, repair services, entertainment and recreation services and hotels.
- x The business environment is the collection of internal and external business system which is relatively controllable and uncontrollable. The internal business environments include the customer, suppliers and near intermediates. These are relatively controllable. The external business environment includes the economic, legal, socio, cultural, physical and technological factors. The ways in which a firm operates and adjusts its business are highly influenced by these factors. So business organizations should sense these business environment factors that are taking place and should adjust their business strategies of operations accordingly.

## Review questions

Part I. Choose the best answer from the given alternatives.

1. Goods and services are

- a) outputs of business enterprises
- b) means to satisfy needs and wants
- c) basic needs to be satisfied
- d) all except choice c

2. The need for food, shelter and clothing are called\_\_\_\_\_.

- a) basic needs
- b) social needs
- c) individual needs
- d) none of the above

3. Which one of the following is true?

- a) human wants are limited but resource are unlimited
- b) human wants are unlimited but resources are limited
- c) business satisfies needs but not wants
- d) business satisfies wants but not needs

4. One of the following is not a feature of convenience goods

- a) widely available
- b) relatively low prices
- c) purchased frequently
- d) requires extensive effort

5. The growth, stagnation and fall of the economy in a period of time is

- a) business transaction
- b) exchange
- c) business cycle
- d) global economy

6. What are basic forces that move a person to do something?

- a) Wants
- b) Needs
- c) Demands
- d) Goods

7. Which of the following is a producer goods consumed in the operation of manufacturing process?

- a) Capital item
- b) Raw materials
- c) Supplies
- d) Component parts

8. In hospitals service value exists only when the patient is there. This statement describes:

- a) Service perishability
- b) Service variability
- c) service intangibility
- d) service inseparability

9. Which type of the tax levied on sale of goods or services?

- a) Payroll tax
- b) Corporate income tax
- c) Consumption tax
- d) Income tax

10. A collection of related businesses that all work together to supply the total demand for a particular kind of goods or services is called \_\_\_\_\_
- a) Environment
  - b) Industry
  - c) Hotels
  - d) Market

Part II. Define the following key terms

- a) Services
- b) Trade channel
- c) Physical distribution
- d) System
- e) Depression

Part III. Answer the following questions briefly.

- a) Describe how business enhances quality of life.
- b) State the features of a free market economic system.
- c) Describe how the physical environment and business influence each other.

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