

Lecture 1:

What is Business activity?



LEARNING OUTCOMES

After this lecture you should be able to:

- Describe the concept of needs, wants, scarcity and opportunity cost
- Restate the factors of production
- Give original examples of the development of economic activity and the use of specialization
- Summarize the purpose of business activity
- Demonstrate the concept of added value
- Describe the classification of business activity

LECTURE CONTENT

- The concept of scarcity
- Opportunity cost
- Specialization
- The role of business
- The concept of added value and some examples
- Classification of business activity according to incremental added value

SCARCITY

- What are your needs?
- *those things that are necessary for living*
- Ex: water, food, shelter, clothing etc.,
- What are your wants?
- *those things that you would like to be able to buy*
- Ex: luxury car, iPhone X, 500 sq.m. house, etc.,
- What is scarcity?
- *is the lack of sufficient products to fulfil the total wants and needs of the population*

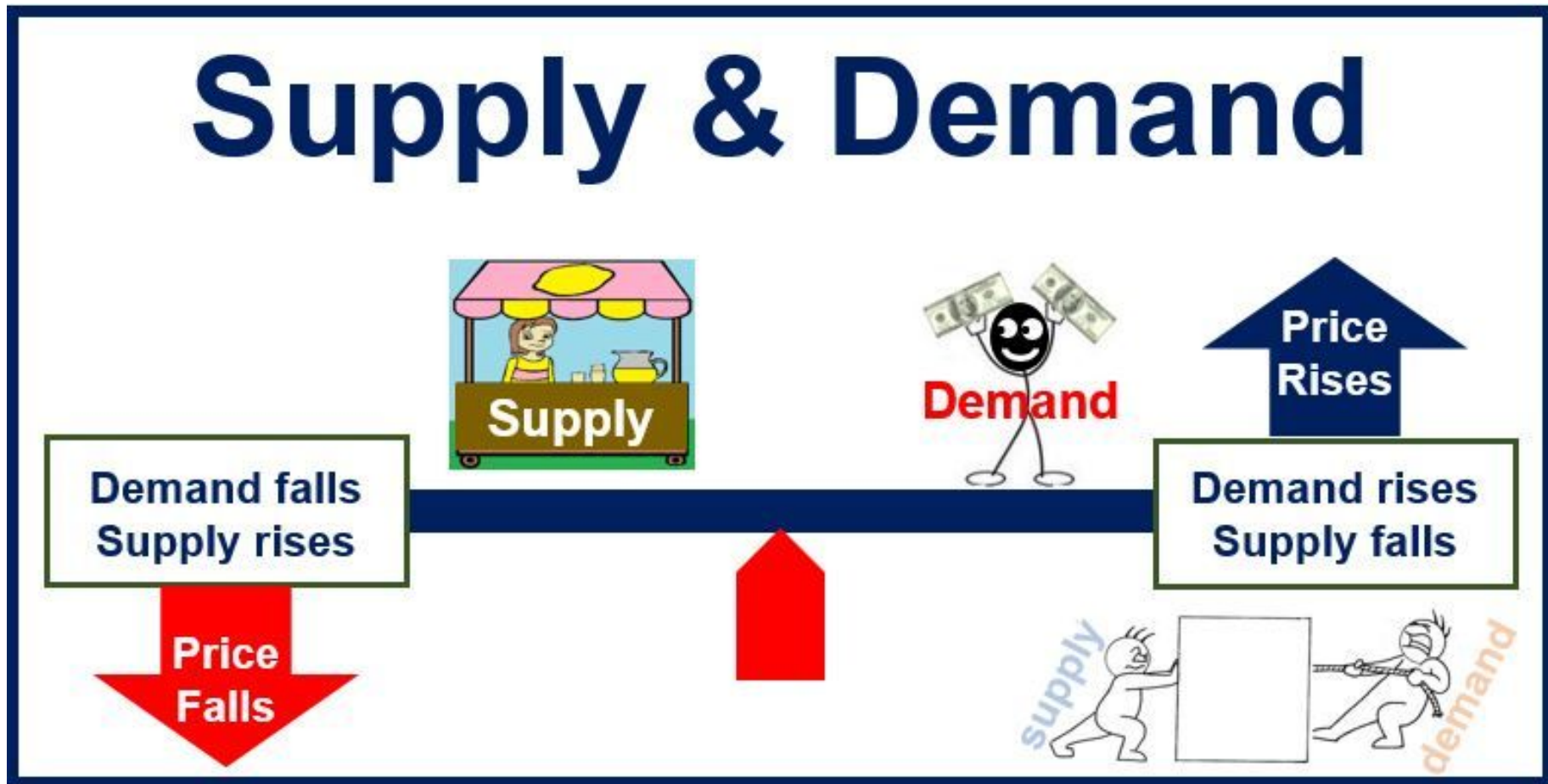
CASE STUDY

The government of a small country is worried about large numbers of people who cannot afford basic needs of life. Even rich citizens are complaining that the country is not producing enough of the luxuries that they want to buy. The government decides to 'solve' the problems by printing more bank notes (money) doubling everyone's incomes.

- Has the government solved the economic problem?
- Are there more goods to buy? More cars, houses to buy?

NO, printing money does not produce more goods, you will just pay twice for the same amount of goods

Supply and demand



SCARCITY

- What is the root-cause for scarcity?
- 4 major constraints for the production of goods:
- Natural resources - oil & gas, metals, minerals
 - Labour – the number of people available and capable to produce goods
 - Capital – money, physical infrastructure (machinery, equipment) to manufacture goods
 - Enterprise – risk-taking skillful entrepreneurs who bring all the factors together

OPPORTUNITY COST

- Given the fact that we are all limited in recourses, there is a need to choose, prioritize
- Making choices can be tough and depends on many measurements such as monetary net benefit, satisfaction, convenience, long-term benefits and so forth.

CASE STUDY

- *You want to buy a car and have \$100 000. You are given two options, both having the same price:*
- Range Rover: better driving experience
- Lexus LS 570: cheaper maintenance



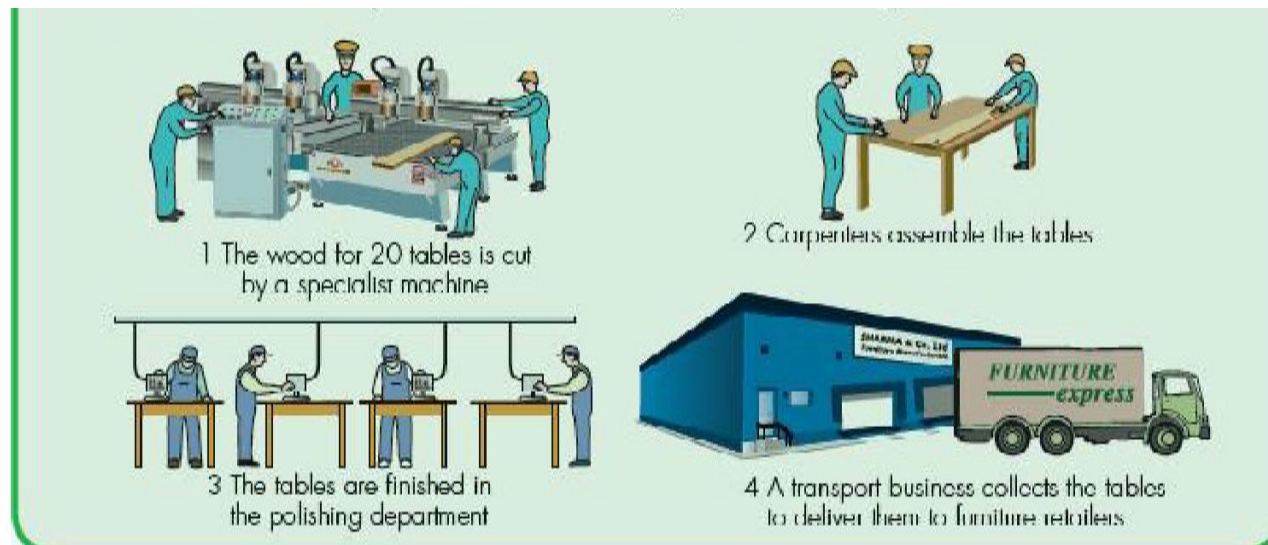
OPPORTUNITY COST

- If you look at decision making from the perspective of
 - $\text{net monetary benefit} = \text{benefit} - \text{costs}$
- probably you will end up with Lexus
- BUT, again it depends on how you measure the benefit (driving experience or reliability)

- So when making a choice you should look at the alternative and look at the opportunity cost
- *Opportunity cost – is the next best alternative given up by choosing the best option.*
- If you opted for Lexus, your opportunity cost will be Range Rover.
- Why we need to know the opportunity cost?
- To ensure that opportunity cost does not have a higher value than the item we are buying

CASE STUDY

This is Joe, a carpenter, went about making a table 200 years ago and now:



SPECIALIZATION

- Why is it better to specialize on a certain task, narrowing down the *scope* of your activity?
- Because it is more efficient!
- Less effort
- Faster
- Higher productivity
- More convenient
- Safer

- Advantages of specialization:
- Workers narrow down their *scope* of activity – this increases efficiency and scale of production
- Less *lead time* (time needed to produce finished good)
- Potential pitfalls of specialization:
- If one specialist is absent with no substitute - production might stop
- Employees get bored from doing just one job – efficiency might fall

THE PURPOSE OF BUSINESS ACTIVITY

- Who do you think produces food, delivers and sell it in the supermarket?
- Who owns and runs all these facilities?
- Who manufactures clothing, builds houses and provide different services such as transportation and communication?
- Government? Well, it used to be like that during USSR times
- Nowadays – businesses produce and deliver our wants and needs

THE PURPOSE OF BUSINESS ACTIVITY

- The biggest manufacturer and retailer of clothing Inditex group who owns:

ZARA



Massimo Dutti

• SINCE 1985 •

PULL&BEAR

Bershka

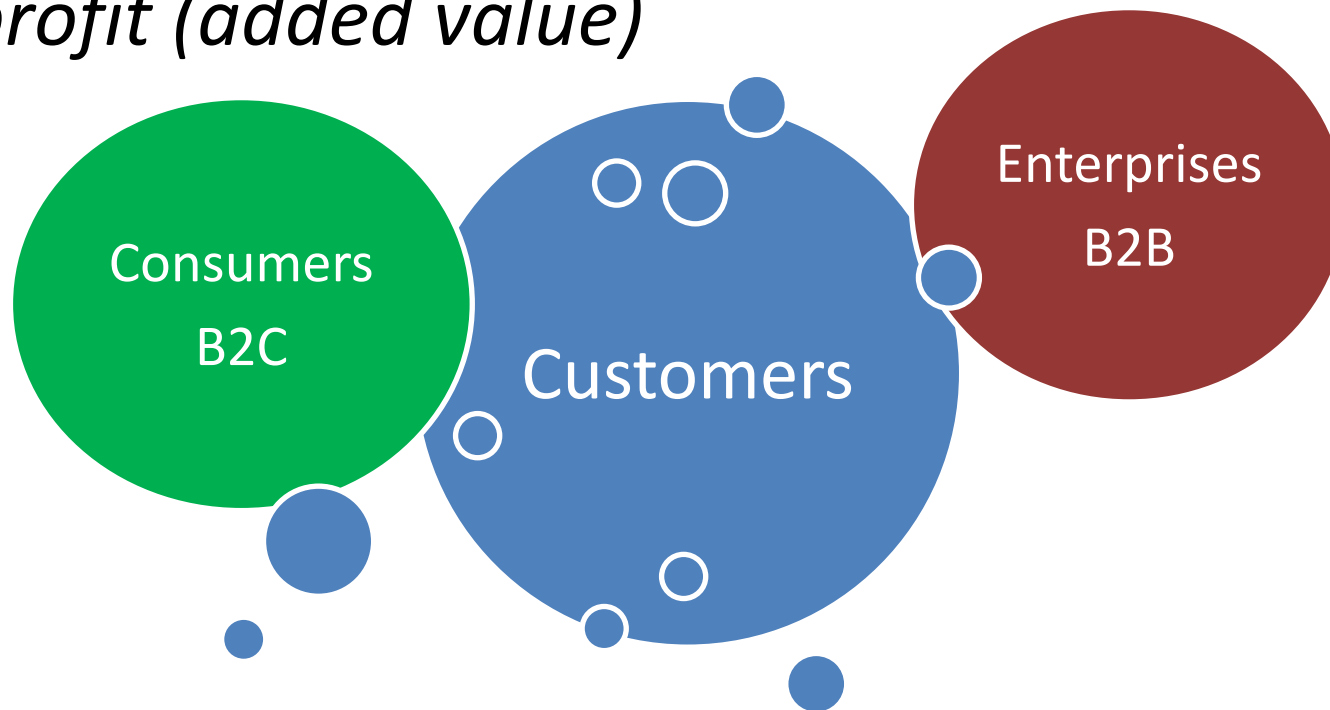
Stradivarius

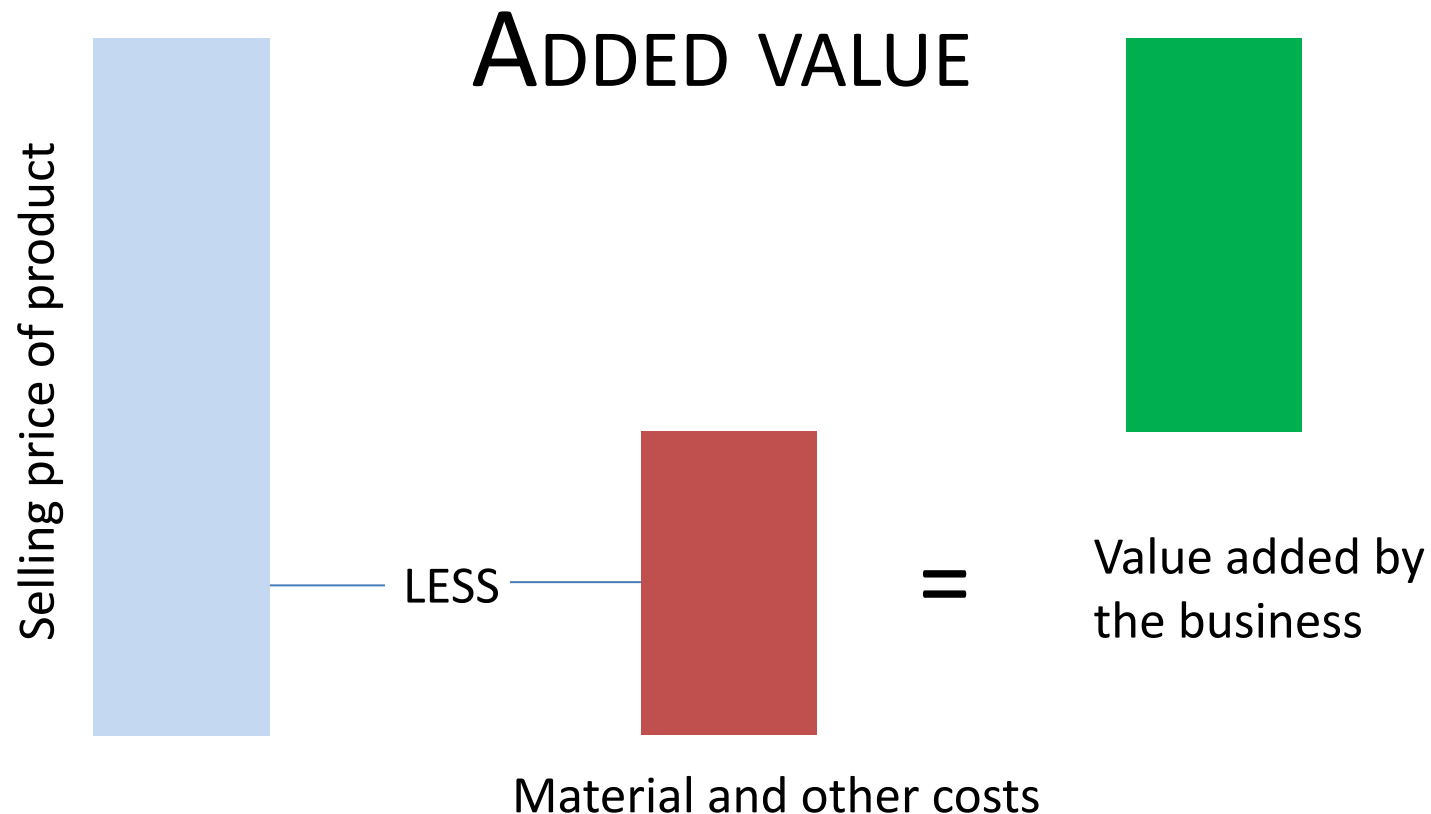
ZARA
HOME

OYSHO

THE PURPOSE OF BUSINESS ACTIVITY

- Businesses combine factors of production to make products (goods and services) which satisfy customers' wants and needs to make profit (added value)*





- *Added value is the difference between the selling price of a product and the cost of bought materials and components*

CASE STUDY

Samal's bakery today has sold 25 croissants at the price of 500 KZT each. The cost of ingredients is 100 KZT each and other costs such as rent, salary and utilities is 150 KZT each. Calculate the added value, profit of Samal's bakery from croissants sales today.



- Revenue = price \times quantity
- Profit (added value) = revenue – costs
- Revenue = 500 KZT \times 25 = 12,500 KZT
- Total costs per croissant = 100 KZT + 150 KZT = 250 KZT
- Total costs for 25 croissants = 6,250 KZT
- Profit (added value) = 12,500 – 6,250 = 6,250 KZT

CASE STUDY

All businesses question themselves how they could earn more.

Can you suggest ways to increase the net profit (added value) of Samal's bakery by 25%?



- Scenario 1: increase price per croissant by 25%
- Scenario 2: increase the volume of sales by 25%
- Scenario 3: reduce costs by 25%
- Scenario 4: combination of two or more scenarios

Not an easy task, in this course you will learn how and when abovementioned scenarios could be utilized

PROFIT MARGIN, PRICE AND VOLUME

- *Profit margin* is a measure of profitability given in % calculated as follows:

$$\text{Profit margin} = (\text{Added value} / \text{Revenue}) \times 100$$

- Profit margin gives a good sense of how effectively the added value is generated
- *Revenue* can be calculated as:

$$\text{Revenue} = \text{Price per unit} \times \text{volume}$$

- *Break-even point* is the point at which business is not making any profit

CLASSIFICATION OF BUSINESS ACTIVITY

- Businesses can be classified into stages as:

Primary – extracting natural resources (e.g. mining companies, farmers)

Secondary – converting raw materials into processed goods (manufacturers, construction)

Tertiary – providing services to both customers and enterprises (logistics, retailing)



Extracting raw materials

- Mining companies



Processing and manufacturing

- Manufacturers, refineries, assembly points



Delivery and Sales

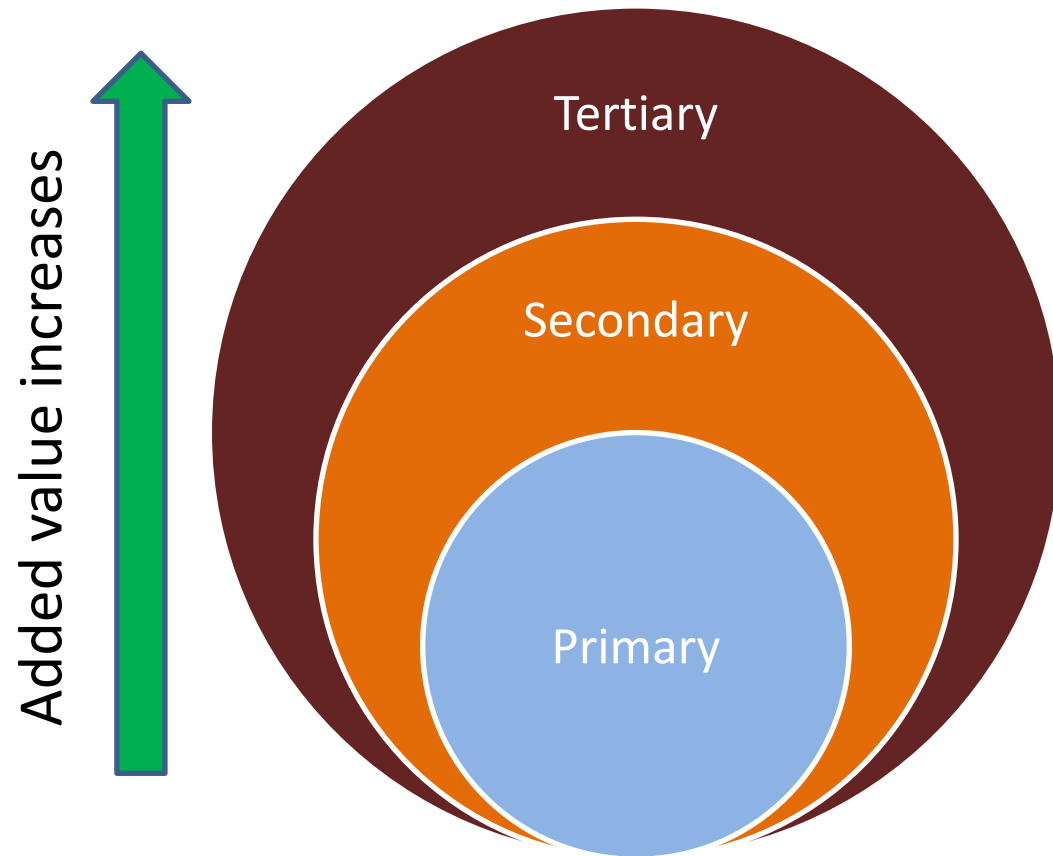
- Transportation providers
- Supermarkets
- Online retailers



lamoda



- Why is it important to know and distinguish between sectors and stages?
- They have different added values!



Usually, developing countries have greater contribution from primary and secondary sectors, thus lower added value.

Whereas developed countries' national output is coming from tertiary sectors, hence higher added value.

CASE STUDY

India does not have large reserves of primary products (natural resources), but Botswana has one of the largest diamond mines in the world. Extracting this valuable resource makes a huge contribution to the Botswana economy.

India's textile, steel and car manufacturing industries are rapidly growing. On contrast the secondary sector in Botswana is small. If Botswana developed a jewelry industry making rings and other jewelry from the extracted diamonds, secondary production would increase.

The tertiary sector is expanding in both countries – tourism is very important in Botswana, and India's IT services is the largest in the world.

% of total national output 2011	Primary	Secondary	Tertiary
Botswana	35	13	52
India	14	29	57

Seminar activity [Go to: www.kahoot.it]

- **Q1:** Give examples of tertiary production based on the case of India and Botswana
- **Q2:** Identify where the primary sector is more important and why
- **Q3:** What should Botswana do with the diamond ores to gain more added value?

Reference list:

1) Borrington, K. and Stimpson, P.
(2013). *Cambridge Igcse Business Studies*. 4th
ed. London: Hodder Education, pp.2-19.