

Chapter 1

NATURE & PURPOSE OF BUSINESS



BY ANKUR AGGARWAL

B.com, MA, M.com, PGDT,
CA(I), MBA, B.Ed, P.hd*

(Faculty of CA. Institute)

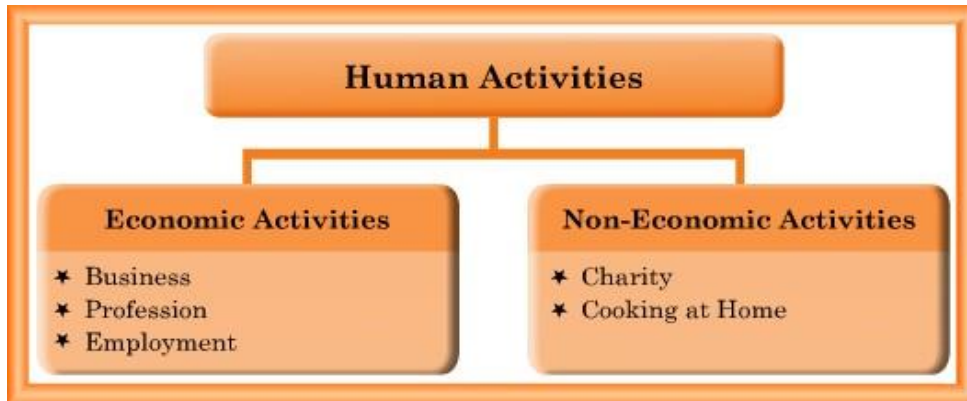
RKG
INSTITUTE

CHAPTER -1

NATURE AND PURPOSE OF BUSINESS

❖ **Human Activities**

Humans carry out various activities to satisfy their different kinds of needs including livelihood, psychological and financial needs. These activities are known as human activities. Human activities can be classified into two main categories: economic activities and non-economic activities.



➤ **Non-Economic Activities**

These activities are carried out by an individual to fulfil psychological needs; these activities are undertaken for self-satisfaction rather than for earning income or profit—for example, contributing to charity, cooking food for the family, etc.

➤ **Economic Activities**

As against non-economic activities, these activities are carried out with the basic objective of earning income or profit—for example, a teacher teaching in a school, a worker working in a factory, etc. Economic activities can further be classified into three categories: business, profession and employment.

❖ **BUSINESS**

➤ **Meaning/Concept of Business**

- The word ‘business’ has been derived from the word ‘busy’, which means engaged in an activity.
- A person engaged in a business deals with the trading of goods or services on a regular basis.
- The sole motive of carrying out a business is to earn profit.

➤ **Features of Business**

i. Economic activity: As a business is carried out with the sole objective of earning profit, it is characterised as an economic activity.

ii. Procurement of raw materials : Business involves procurement of raw materials and semi-finished goods, which are then processed into final goods. These final goods are then sold to the end consumers at higher prices. (It must be noted that the resale of goods and services on a regular basis also constitutes a business.)

iii. Profit motive: Earning profit is the sole and the most important objective of all business activities.



iv. Exchange of goods and services: Business basically involves an exchange of goods and services for money.

v. Regular basis: The exchange of goods and services (as mentioned in the point above) is done on a regular basis. A single or only a few transactions of exchange do not constitute a business.

vi. Business risk: Every business, irrespective of its size (large or small) and the types of goods it deals in, faces business risks (in the form of loss).

vii. Customer satisfaction: Besides the profit motive, a business also aims at satisfying consumers' wants. A business must produce goods and services considering consumers' needs.

❖ ROLE OF PROFIT IN BUSINESS

Earning adequate profit (excess of income over costs incurred) is the sole motive of any business. Without sufficient profits it would not be possible for a business to sustain itself for a long time. Profit forms the source of reinvestment in a business and thus enables the growth of the business. The following diagram depicts the role of profit in a business

i. Source of income: To every businessman, profit from the business forms the source of income and livelihood.

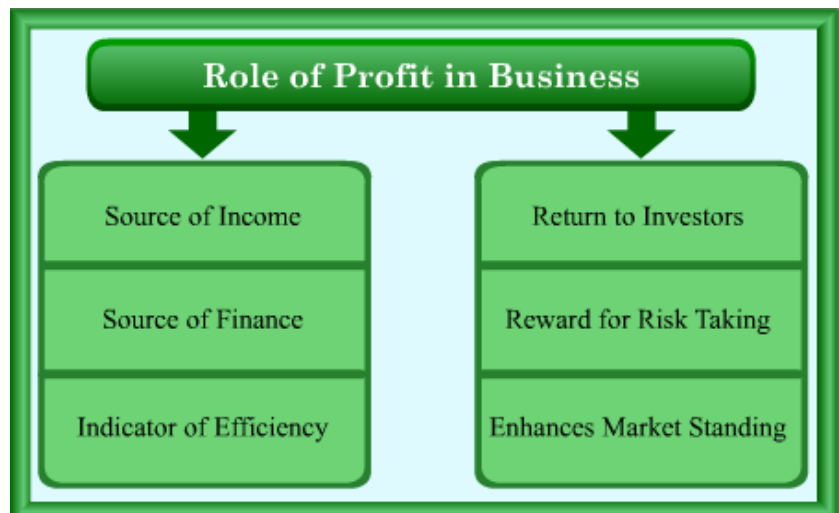
ii. Source of finance for future growth: A part of the profits earned is reinvested by the businessman into the business to facilitate its growth.

iii. Indicator of efficiency: Profits earned by a business can be considered an indicator of the efficiency or performance of the business. In other words, higher profits indicate greater success of a business and vice versa.

iv. Enhances the business's standing in the market: Over a period of time, if a business earns sufficient profits, it gains market standing and reputation in the public eye.

v. Reward for risk taking: Profit is said to be the reward or compensation for the risks taken in the business.

vi. Return to investors: As a business earns profits, it gains reputation and goodwill in the market; this, in turn, increases the market price of its shares. In this way, profits also increase the return for the investors.



➤ Can profit be the sole motive of a business?

Although conventionally a business is carried-out with the sole aim of earning profit, however, now-a- days, with the growing diversities, business has expanded its definition in terms of its objectives. It is no more limited to just earning profits but has grown beyond that. Therefore, a business needs to have multiple objectives.

❖ Multiple Objectives of Business

Business objectives are the results that every business aims at achieving. The following diagram depicts various objectives of a business.

Following are the multiple objectives of a business:



i. Innovation: Business calls for developing new and sophisticated techniques by incorporating new thoughts and ideas so as to meet the growing demands of consumers; it is a never-ending process.

ii. Profit maximisation: Earning maximum possible profit is the basic motive of every business.

iii. Market share: Every business enterprise aims at capturing maximum market share.

iv. Workers' performance and their attitude:

The productivity and profitability of a business are dependent on its workers' performance and their attitude. In this regard, every business aims at maximising the efficiency and productivity of its workers.

v. Social responsibility: Because a business uses the resources of the society, it has certain responsibilities towards it. These responsibilities are called social responsibilities.

vi. Performance and development of manager: A business enterprise tends to conduct various programmes to improve the performance of its managers. This is because efficient managers help in improving the performance of the workers and increasing the profits of the business.

vii. Resources: Every business requires physical and financial resources to produce goods and services. These resources must be put to optimum use by the business.

viii. Productivity: Every business should aim at greater productivity through the effective utilisation of available resources.

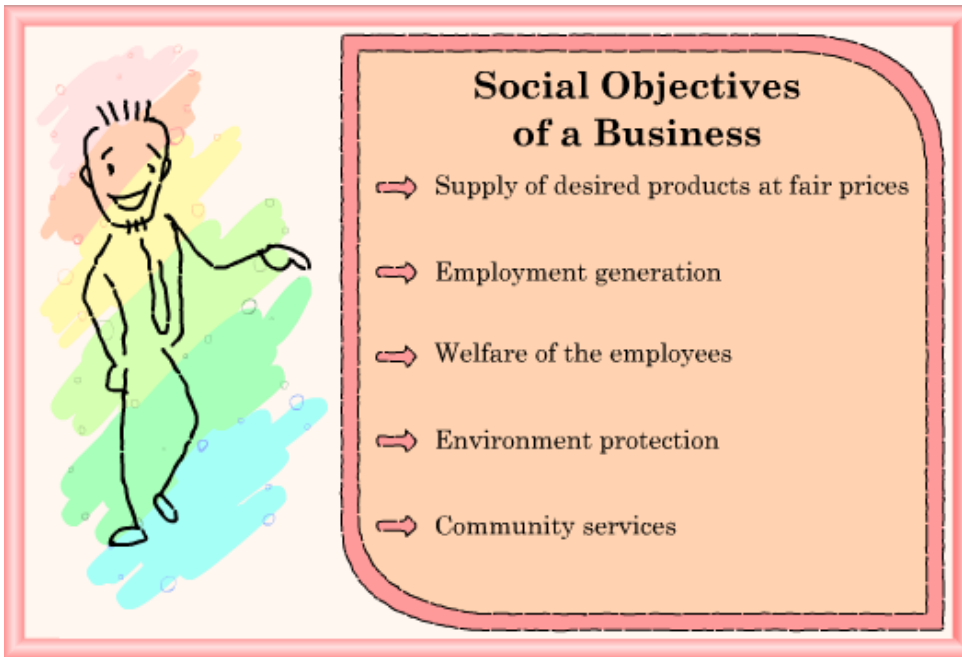
❖ Economic Objectives

i. Earning profits: Earning profits is the main objective of every business. Profit forms the income for the businessman and is reward for his risk-bearing ability.

ii. Survival: Every business must aim to survive in the market in the long run by giving due regard to forces such as competition, consumer needs, sources of finance, government regulations, etc.

iii. Growth and development: Businesses must grow and develop so as to capture maximum market share and earn maximum profits.

❖ Social objectives of Business



Following are the social objectives of a business:

- i. Supply of desired products at fair prices:** A business should produce and sell products of the desired quality to live up to the expectations of its customers.
- ii. Employment generation:** Every business should create employment opportunities so that many people can get employment without any discrimination on grounds of caste and creed.
- iii. Welfare of the employees:** Business enterprises should provide good working conditions to their employees. They should also pay fair wages to their employees for their work.
- iv. Environment protection:** Business enterprises should adopt adequate measures to protect the environment; they should use environment-friendly techniques of production.
- v. Community service:** Business organisations should actively participate in community services; they can open schools, orphanages, hospitals, etc., for the overall welfare of the society.

❖ Profession

A profession is an occupation that requires highly specific and in-depth knowledge of the relevant field. Every profession is different from the other in terms of the knowledge and skills required to practise it.

➤ Features of Profession

Following are some of the main features of a profession:

- i. Professional degree and knowledge:** A profession requires an individual to possess in-depth knowledge of the field.
- ii. Code of conduct:** Every profession follows an ethical code of conduct as prescribed by the concerned professional associations.
- iii. Limited capital investment:** Practising a profession requires limited capital investment.

iv. Professional association: Every profession is associated with a professional association/body that provides guidelines for the behaviour/code of conduct of the members.

v. Restricted entry: Entry in a profession is restricted through some requirements such as possession of a specific degree, knowledge of a specialised skill and membership of some professional association.

vi. Service motto: Every professional aims at giving prime importance to client servicing.

❖ Employment

In this type of economic activity, individuals are hired by an organisation to work on a regular basis and are paid in exchange of their services.

➤ Features of Employment

Following are some of the basic features of employment:

i. Easy commencement: Employment commences as soon as the appointment letter and the service agreement is signed by the employee.

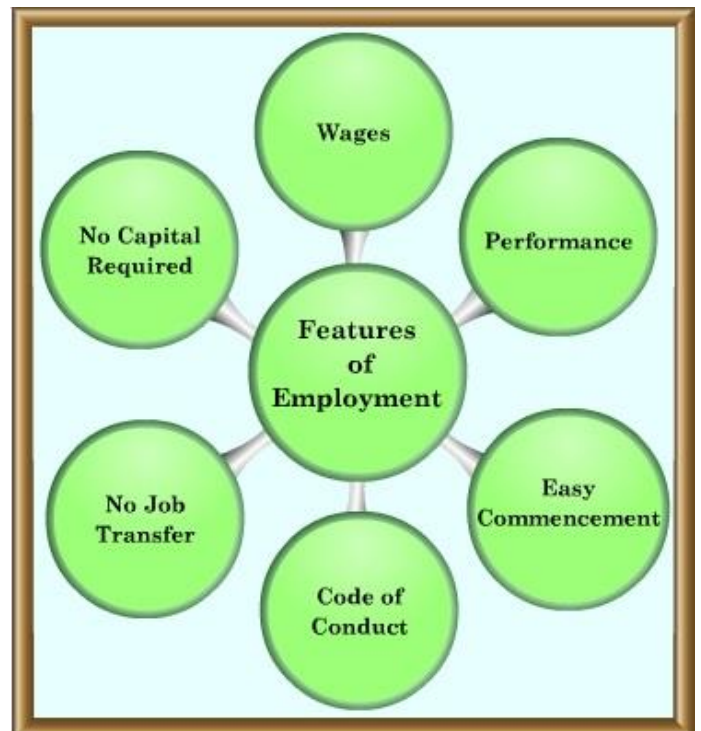
ii. No capital required: No capital is required to enter into a service or employment.

iii. Code of conduct: It is mandatory for every employee to follow the rules and regulations prescribed by the employer of the company.

iv. No job transfer: Employment cannot be transferred from one person to another or from one organisation to another.

v. Performance: An employee needs to perform the tasks and duties assigned by the employer.

vi. Wages: Employees are given wages or salaries by the employer as remuneration for their services.



Basis of Difference	Business	Profession	Employment
Commencement	Can be started by an entrepreneur depending on his or her decision to do so	Can be practiced only after successful completion of a (professional) degree or a certificate course.	Commences as soon as the appointment letter and the service agreement is signed by the employer and the employee.
Investment required	It varies as per the size and nature of the business.	Limited	Nil
Risk involved	The degree of risk involved depends on the nature of goods produced dealt in by the business and the scale of business operations.	Comparatively low	Nil
Transfer of ownership	It is possible and subjected to the fulfilment of certain legal formalities.	Ownership cannot be transferred, as the professional himself/herself procures the required degree and skills.	Ownership cannot be transferred.
Reward or remuneration	Profit	Fees	Wages/salary
Code of conduct	A business does not require a code of conduct.	The code of conduct is prescribed by professional associations.	The code of conduct is prescribed in the form of terms and conditions laid down by the organisation.
Qualification	No minimum qualification is required.	Prescribed professional qualification is required.	It depends upon the nature of the job

❖ Classification of Business Activities

Business activities can be classified into two broad categories: industry and commerce.



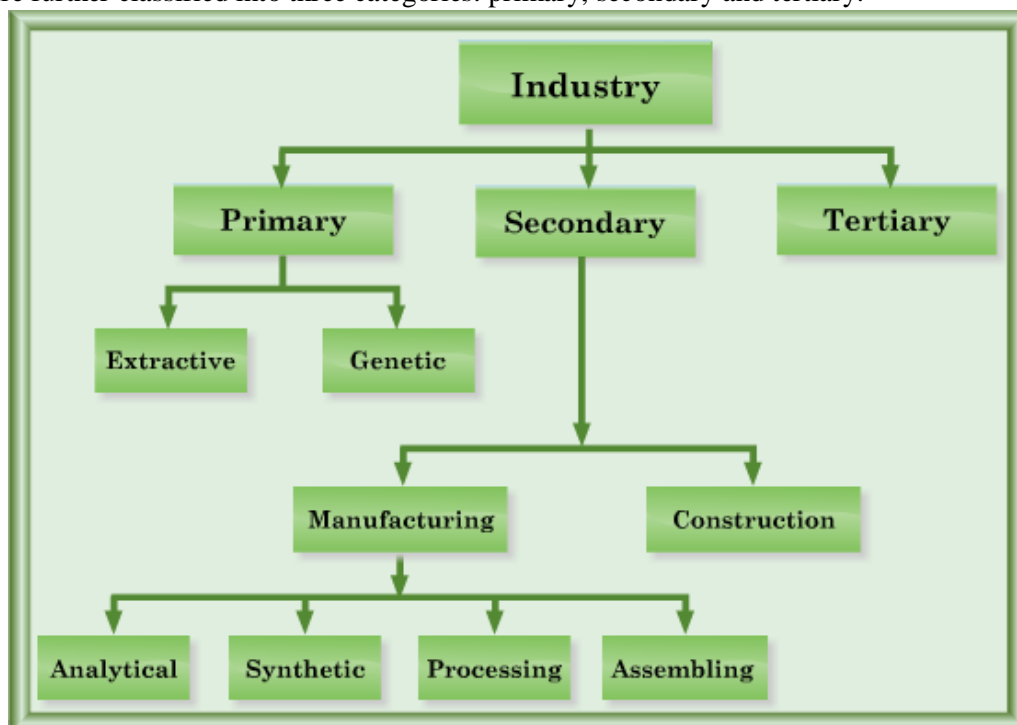
❖ Industry

➤ **Definition:** Industry refers to those economic activities wherein raw materials are processed and converted into final products.

During the process, value addition to the raw materials takes place. The final products have the higher value compared to the raw materials.

➤ Classification of Industries

Industries are further classified into three categories: primary, secondary and tertiary.



➤ Primary Industries

These industries undertake activities related to the extraction and processing of natural resources. Based on the nature of activities performed, primary industries can further be classified into extractive and genetic industries.

i. Extractive industries: These industries deal with the extraction and refinement of natural resources.

ii. Genetic industries: These industries undertake activities related to the breeding of plants and animals that are then used for further reproduction.

➤ Secondary Industries

These industries acquire raw materials (the final products of primary industries) and further process them into final goods. These industries can further be classified in two categories:

i. Manufacturing industries: These industries process raw materials or semi-finished goods into finished products, which can readily be used by the final consumer. Manufacturing industries can further be classified in four categories:

a. Analytical industries: These industries analyse a single product (raw material) and then refine and separate different elements from it to prepare the final product.

b. Synthetic industries: These industries combine different raw materials, which serve as ingredients, to produce a new product.

c. Processing industries: In these industries, the raw material is processed and refined in various stages and converted into the final product.

d. Assembling industries: These types of industries combine various smaller components to form a new final product.

ii. Construction industries: These industries are concerned with the construction and development of infrastructure such as buildings, bridges, dams and roads.

➤ Tertiary industries

These industries constitute the service providers that facilitate the operations of primary and secondary industries.

Some of the major services provided by tertiary industries are banking and credit facilities, communication and transportation.

❖ Commerce

➤ **Definition:** It involves the trade/exchange of goods and services. Unlike industry, commerce does not involve production.

➤ Functions/Role of Commerce



Commerce bridges the gap between the producers and the sellers and removes the hindrances in the process of exchange. Following are the ways in which hindrances in the process of exchange can be overcome by commerce:

i. Trade: It involves the exchange of goods between producers and consumers, which, in turn, helps in making the goods available to consumers easily. As traders serve as a link between the producers and the customers, they overcome the **hindrance of person**.

ii. Insurance: It helps in recovering the losses incurred in case of any damage. Thus, insurance acts as a shield against the risks and overcomes the **hindrance of risk**.

iii. Transportation: Transportation enables the producers to move their goods to the market in order to sell them to the consumers. This helps in overcoming the **hindrance of place**.

iv. Banking: Efficient banking facilities easy and ready availability of cheap credit to businessmen and traders. This helps in overcoming the **hindrance of finance**.

v. Storage and warehousing: Modern technology has facilitated the production of goods in large quantities. Warehousing helps the producers in storing goods until they are sold to the final consumers, thus overcoming the **hindrance of storage**.

➤ **Classification of Commerce**

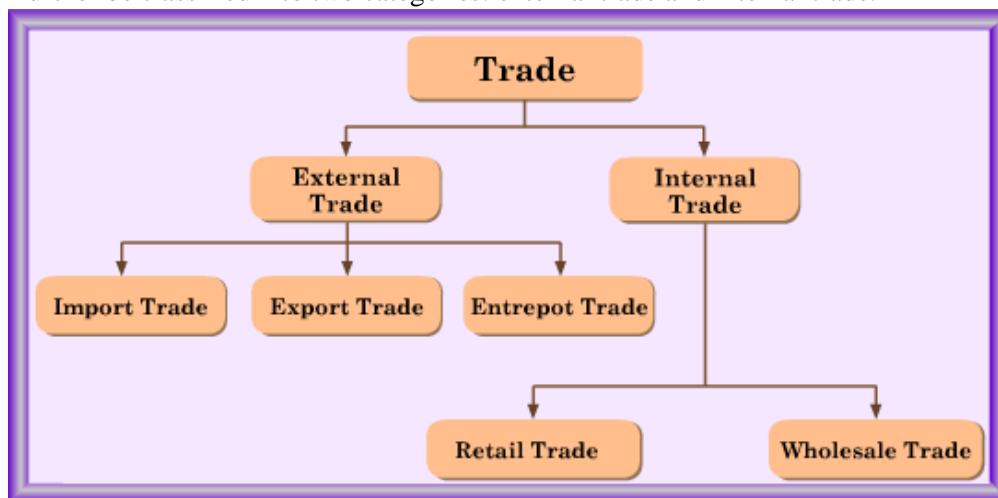
Commerce can be classified into two categories: *trade and auxiliaries to trade.*

❖ TRADE

Meaning: Trade refers to the buying and selling of goods and services.

➤ **Classification**

Trade can further be classified into two categories: external trade and internal trade.



➤ **External trade**

The trade that takes place between two or more countries is known as external trade.

Following are the various forms of external trade:

i. Import trade: It refers to the purchase of goods and services from foreign countries in order to consume them in the native country.

ii. Export trade: It refers to the selling of goods and services from the native country to the foreign countries.

iii. Entrepot trade: It involves importing goods from a foreign country with the purpose of exporting them to another country at a higher price.

➤ Internal trade

The trade that takes place within the boundaries of a country is known as internal trade. Following are the two forms of internal trade:

i. Wholesale trade: It refers to the buying and selling of goods in large quantities for the purpose of resale or intermediate usage. These goods are purchased in bulk from the manufacturers and are later sold to retailers in relatively small quantities.

ii. Retail trade: It refers to the buying of goods and services in relatively less quantities unlike that practised in the wholesale trade. These goods and services are then sold directly to the customers.

❖ AUXILIARIES TO TRADE

➤ **Definition:** It comprises all trade-related activities that facilitate the exchange of goods and services.

➤ Types of Auxiliaries to Trade

Following are the various types of auxiliaries to trade:

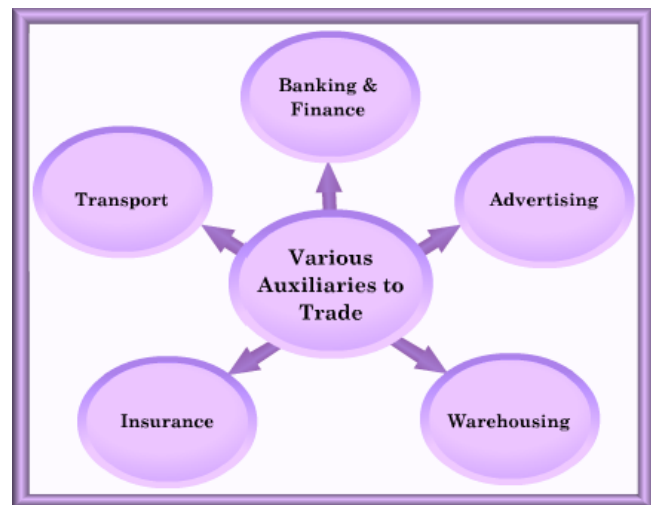
i. Banking and finance: An efficient banking facility ensures easy and ready availability of cheap credit to businessmen and traders.

ii. Advertising: Advertisements enable businessmen to reach to a large number of potential buyers. This helps them in increasing their sales.

iii. Warehousing: It refers to storing or preserving goods until they are sold for final consumption. It helps businesses to store goods and facilitates the availability of goods when required.

iv. Insurance: It acts as a shield against various business risks. By paying a nominal premium at regular intervals, the loss suffered by a business (in case of any accident or mishap) can be recovered from the concerned insurance company.

v. Transportation: It widens the geographical boundaries of a business and enables the sale and purchase of goods across different regions.



❖ BUSINESS RISKS

Definition: Business risk refers to the possibility that the business may fail to earn sufficient profits or incurs losses due to certain unforeseen circumstances which are beyond its control.

➤ Types of Business Risks

Business risks can be classified in two broad categories: speculative business risk and pure business risk.

i. Speculative business risk: It refers to an **equal** chance of earning profits and incurring losses. It arises because of changes in external forces.

ii. Pure business risk: It refers to the chance of incurring either **only** losses or no loss at all.

❖ Nature of Business Risks

Following are some features of a business risk:

i. Part and parcel of business: Risk is an essential feature of every business. Every business, irrespective of its size and nature, faces a certain amount of risk.

ii. Result of unforeseen circumstances: Risk usually emerges because of unforeseen circumstances. These uncertainties may occur in the following forms:

- a. Human uncertainties such as strikes and thefts
- b. Business uncertainties such as price change and changes in the government policies
- c. Natural uncertainties such as earthquake and floods
- d. Other uncertainties such as political disturbances and fluctuations in the exchange rate

iii. Directly related to profit: Profit is directly related to risk as profit is said to be the reward for undertaking risks.

Higher risk → Higher profits

iv. Degree of risk: The degree of the risk involved varies from business to business depending upon the nature of the business and the size of its operations.

❖ Causes of Business Risks

Following are the various causes of business risks:

i. Natural causes: Unforeseen natural calamities, such as earthquake, flood and famine, cause heavy and irreplaceable losses to a business. The business risk that comes from natural elements is beyond the control of any business.

ii. Economic causes: These causes are related to the uncertainties associated with changes in competitors' policies and change in price and consumer preferences.

iii. Human causes: These causes are directly related to the actions of human beings. Carelessness, strikes and riots are some of the human causes.

iv. Other causes: Besides the causes mentioned above, there are a few unpredictable events that cause a business risk—for example, political disturbances, exchange rate and interest rate fluctuations and budget amendments.



❖ Factors to be considered before starting a business

Following are some of the important factors that must be taken into consideration before starting a business:

i. Selecting the line of business: This is the foremost decision that involves choosing the kind of product that is to be produced, analysing its existing and future market demand, considering profit margin and determining the level of technical know-how possessed by the entrepreneur.

ii. Scale of the business: Once the line of business is selected, the entrepreneur needs to decide whether he wants to operate his business on a large or small scale.

iii. Location: An appropriate location must be selected based on factors such as easy and cheap availability of raw materials and labour, transportation, power and other infrastructural facilities.

iv. Finance: As finance is required for every aspect of business; therefore, before starting a business, the feasibility of various fund-raising alternatives (as against the requirement) must be carefully analysed.

v. Physical requirements: These requirements include machinery, equipment, tools and technology that add to the efficiency of a business.

vi. Plant layout: After the physical facilities have been taken care of, the layout of the plant needs to be finalised.

vii. Efficient and dedicated manpower: A competent and trained workforce is required to start the business operations.

viii. Tax planning: Tax planning as per various tax laws in the country must be done carefully.

ix. Starting the enterprise: After considering the above mentioned factors and accordingly taking a suitable decision, a businessman can commence the operations of his enterprise.

