Examples of tertiary sector business activities include:

- Advertising
- Banking
- Catering
- Communications (telecommunications and Internet)
- Distribution
- Education
- Health care
- Insurance
- Legal services
- Leisure and entertainment
- Medicine
- News broadcasting
- Real estate (commercial and residential property)
- Retail
- Transportation
- Travel, hotels and tourism
- Security services
- Warehousing

The **added value** of tertiary sector output is very high. For example, households are generally willing to pay the high prices charged by a plumber to fix a leaking water pipe. This is because the plumber provides high added value services to the consumer by fixing the leak, something that the consumer has no expertise or time to complete.

In general, as an economy grows and develops, the significance of the primary sector diminishes (in terms of output and employment), whereas the importance of the tertiary sector becomes more prominent.

The quaternary sector

The **quaternary sector** refers to business activity involving the creation or sharing of knowledge and information. It involves using computer and digital information technologies.

Examples of production activities in the quaternary sector include:

- Tertiary and higher education
- Information and communications technology (ICT)

Opportunities for starting up a business

There are many interrelated opportunities that lead people to starting their own businesses or an enterprise. These reasons include:

- **Money** – Perhaps the key driving force for a person to start their own business is the ambition or motivation to earn profit for themselves. A firm earns profit by selling its products at a price that is higher than its production costs. The owner(s) get to keep the profit as a reward for risk-taking and their entrepreneurship talents.

- **Autonomy** – Many people set up their own business to be their own boss, rather than working for someone else. Some people do not like to work for other people and prefer the autonomy that comes with being an entrepreneur. There is a great sense of satisfaction in being the "boss". The autonomy of being your own boss also speeds up decision-making.

- **Challenges** – Some people are driven by personal challenges. They enjoy the satisfaction of achieving what they perceive to be greatness and striving for self-actualisation.

- **Passions** - Some entrepreneurs want to pursue their personal passion/interest and turn this into a business opportunity. For example, Linda McCartney (who married Paul McCartney of the Beatles) was an animal rights activist and entrepreneur who started the famous food brand Linda McCartney Foods, specialising in vegan and vegetarian meals. For such entrepreneurs, the aim of starting their own business is not always to earn a profit.

- **Family ties** – For some entrepreneurs, running their own business is part of a family tradition. For example, Farr Estate (luxury holiday rentals) in Scotland has been owned as a family business for generations. Other more well-known examples of businesses owned wholly or largely by family members include: Mars (still owned by the Mars family), the Trump Organization, Berkshire Hathaway and Walmart. Take a look at the Forbes website for more examples.

- **Unfilled market opportunities** - Some entrepreneurs spot an unfilled gap in the market for a certain type of good or service, so start their own business. Many online entrepreneurs, for example, have recognised business opportunities in this way, such as Travis Kalanick and Garrett Camp who co-founded Uber in 2009.

- **Making a difference** – Finally, some people start their own enterprises in order to be able to make a difference to others. Examples include providing a service to the local community such as a medical clinic, a day-care centre, or nursing home for the elderly.

- As with sole traders, business affairs of a partnership are kept confidential, so only the tax authorities need to know about the financial position of the partnership.

Disadvantages of partnership

However, there are limitations to setting up a business as a partnership. These potential drawbacks include:

- As the business has more than one owner, this can easily lead to disagreements and conflict between the owners, which can seriously damage the running of the partnership.
- Decision making is slower than with sole traders because there are more owners involved. This can also lead to disagreements and conflicts between the owners
- Unlike with a sole trader, the profits made by a partnership must be shared between all the owners.
- In general, partners have unlimited liability so are liable for any debts, fines, penalties or lawsuits against the business, even if these were caused by another partner in the firm. However, sleeping partners are exempt from unlimited liability.
- Compared to limited liability companies, access to finance is restricted to the finances available from the different partners in the firm. There is no maximum number of owners in limited liability companies, so they can raise finance through their shareholders.
- There is no continuity if a partner decides to leave the firm or if one of the partners die. This is because such cases would void the Deed of Partnership. There would be a time delay in setting up a new partnership agreement.

Privately held companies (AO3)

Companies (also known as corporation) are commercial for-profit businesses owned by shareholders. Hence, the profits of a company belong to and are shared among the various owners. As incorporated businesses, the owners have limited liability. Limited liability protects shareholders who cannot lose more than the amount they invested in the business. This is because shareholders are not personally liable for the debts of the company should it go into debt or bankruptcy.

In legal terms, there is a divorce of ownership and control as the owners (shareholders) are treated as separate legal entities from those who control and run the business (the board of directors and CEO). It is the board of directors and the CEO (or managing director) who are responsible for the strategic direction of the company.

There are two categories of companies: privately held companies and publicly held companies.

Features of privately held companies

- It is also easier for large publicly held companies to borrow money from bank loans and mortgages, due to their lower level of risk for financial lenders.
- As with privately held companies, the shareholders of publicly held companies enjoy limited liability.
- Large publicly held companies get to enjoy the benefits of operating on a large scale, such as opportunities to exploit economies of scale, market share, and market power.
- As with privately held companies, publicly held companies enjoy continuity even if a principal or major shareholder leaves the organization or passes away.

Disadvantages of publicly held companies

The limitations or drawbacks of being a publicly held company include the following points:

- There is a lack of privacy because the general public have access to the financial accounts of publicly held companies.
- Publicly held companies are the most administratively difficult and expensive form of commercial for-profit business to set up and run. For example, there are high costs of complying with the rules and regulations of the stock market.
- As the general public can buy and sell shares freely, there is always a potential threat that a rival company will make a takeover bid.
- Large companies can suffer from diseconomies of scale. Being too large can cause inefficiencies in the company, and hence higher average costs of production.

Key Terms

- **Companies** (also known as **corporation**) are commercial for-profit businesses owned by shareholders.
- A **Deed of Partnership** (or **partnership deed**) is a formal partnership agreement or contract between the owners, which includes legal agreements such as the formal responsibilities of each owner, their voting rights, and how profits are to be shared between the partners.
- An **ordinary partnership** has a minimum of 2 partners and up to twenty owners (although this does vary from one country to another).
- **Partners** are the co-owners of a partnership business.
- A **partnership** is a commercial (for-profit) business that strives to earn a profit for its owners.

Type	Legal Procedures	Ownership	Transparency	Finance	Control/Decision-making	Profits	Liability	Observations
Sole Trader	Minimal procedures Some tax concessions	One owner	Privacy. They must elaborate the financial statements but they only need to publish them to the tax authorities.	Funded by owners, investors, and internal and external sources.	The owner has full control. Centralized decision-making.	Owners keep all the profit	Unlimited liability	It tends to be the first option when starting up a business, for testing the market with minimal waste and admin.
Partnerships	Partners sign a Deed of Partnership	Owned by two or more people (max 20 members depending on the country)	A limited need for published accountability. They must elaborate the financial statements, but they do not have to present them to the Commercial Register.	Funded by owners, investors, and internal and external sources	Partners share responsibilities.	Shared among the members.	At least one of the owners must have unlimited liability	Typical option when there are more than one persona starting up a business. Typical structure for legal firms, doctors.
Privately held companies	The company and the owners are separate legal entities. Lower fees to form than public held companies.	Owned by **shareholders** The **shareholders** are the company's founders, management, or a group of private investors.	No legal requirement for the company to publish detailed financial statements for the general public, but to the Commercial Register.	Funded by owners, investors, and internal and external sources Shares are not available to the general public on an open stock exchange.	Board of directors and the CEO are responsible for the strategic direction of the company.	Shared among the shareholders.	Limited liability	Smaller businesses than Public held companies. Typical formula for family businesses. The next step to take when you are a sole trader, and the business starts growing.

market leader. These advantages include enhanced brand awareness, brand value, and brand loyalty, all of which help a company to protect the interests of their shareholders.

- ***Ethical objectives and* corporate social responsibility** - For a business to remain relevant, profitable, and competitive, it is not enough to only sell more goods and services. Changing attitudes and expectations mean that businesses have to operate in a socially acceptable and responsible way, such as ensuring business activities do not cause damage to the planet or people. Doing so can also improve the corporate image of the company. Only then, can the business generate and protect shareholder value in the long term.

ETHICAL OBJECTIVES (A02)

Ethics are, essentially, about what is deemed to be right and what is considered to be wrong, i.e. morality from society's point of view. They are based on the values of the organization, in accordance to society's norms and beliefs. Read more about ethics as a key concept here.

Business ethics are the guiding principles that provide moral guidelines for the conduct of business activities. Ethical objectives are organizational goals based on moral guidelines in order to influence or determine business decision-making. Ethical decision-making considers more than just calculating costs, benefits and profits. This means such businesses act morally towards their various stakeholder groups, including employees, managers, customers, shareholders, suppliers, financiers, local community (including consideration for the natural environment), the government, and even competitors.

Examples of ethical objectives include:

- improving the overall wellbeing of workers
- honesty and fair treatment with regards to dealings with customers and suppliers
- adopting green (clean / renewable) technologies
- pursuing sustainable growth strategies
- observing and respecting intellectual property rights of others
- using socially responsible advertising, and corporate governance (such as financial integrity and transparency).

- Aiming to improve their own salaries, bonuses and other fringe benefits - just like all employees of the organization.

3. Directors

Directors (or **executives**) are the group of senior managers who are legally responsible for the overall running of a company on behalf of their shareholders (the legal co-owners of the company). In a large company, there is likely to be directors responsible for each key functional area of an organization: marketing, human resource management, finance and accounts, plus operations management.

There are two main types of directors:

- ***Executive directors*** work full-time at the organization and make key strategic decisions.
- ***Non-executive directors*** do not work at the organization but are consultants used for their particular expertise. They advise the Board of Directors on corporate strategy.

Directors must also keep company records and report any changes to the authorities. Other responsibilities of directors include:

- Advising and supporting the CEO
- Filing company annual accounts

- Target setting and devising long term strategic plans
- Establishing organizational policies and codes of conduct / practice; which in turn means shaping the **corporate culture**
- Monitoring and controlling the organization's overall activities and financial results
- Identifying and recording people with significant control (PSC) in the company. Most PSCs are likely to be people who hold:
  1. more than 25% of shares in the company
  2. more than 25% of voting rights in the company
  3. the right to appoint or remove the majority of the Board of Directors.
- Directors also need to be aware that the information of all PSCs is available to the general public, apart from their home address and date of birth.

The interests of directors (or executives) include:

- Equal opportunities legislation
- Health and safety standards and regulations
- Taxation policies and laws.

8. The local community

The **local community** refers to the general public and local businesses (not necessarily competitors though) that have a direct interest in the activities of the business in question. The interests of the local community as an external stakeholder group include:

- Members of the local community try to encourage the business in question to act in a socially responsible way, such as sustainable activities that protect the environment.
- They expect the business to create jobs in the local area.
- The local community may also want financial support (such as sponsorships and donations) for local events.

Conflict between stakeholders (AO2)

Different stakeholder groups have different interests, which can conflict. Conflict refers to the mutually exclusive and incompatible interests of different stakeholder groups. If this is not managed, it often leads to protracted disagreements, disputes and arguments in the workplace.

Examples of possible conflict between different stakeholders' interests include:

- Employees demand higher wages, which raises production costs and reduces the amount of profits from which shareholders receive dividend payments.
- Similarly, senior managers and directors may demand large bonuses for their work, but this may also reduce the profits available to distribute to the company's shareholders.
- Shareholders may demand regular and higher dividend payments, but this may result in less retained profits available for production and marketing managers to improve their functional roles.
- Customers may want lower prices, but this reduces the firm's profit margin so can upset the company's shareholders.
- Employers may want greater efficiency and productivity gains by investing in new technologies, but this might create job losses for employees.

1.5 Growth and evolution

This section of the IB Business Management syllabus examines the growth and evolution of business organizations. Almost all businesses strive to grow, whether this is measured in terms of sales revenue, profits, number of stores/outlets, number of employees, number of customers, or market share.

An example of business growth is Starbucks, which opened as a single coffee store in Seattle, USA in 1971. By the end of 2021, Starbucks had more than 33,800 stores in 80 countries. More than half of their outlets are located outside of the United States.

Businesses often have to evolve their practices and/or products in order to survive. For example, although Samsung is best known for its smartphones and consumer electronic products, the multinational conglomerate is also involved with weapons manufacturing, life insurance and theme park management. Samsung originally started trading as a grocery store.

The learning outcomes (or assessment objectives) for this section of the syllabus are:

- Internal and external economies and diseconomies of scale (AO2)
- The difference between internal and external growth (AO2)
- External growth methods (AO3):
    1. Mergers and acquisitions (M&As)
    2. Takeovers
    3. Joint ventures
    4. Strategic alliances
    5. Franchising
- Reasons for businesses to grow (AO3)
- Reasons for businesses to stay small (AO3)

INTERNAL & EXTERNAL ECONOMIES AND DISECONOMIES OF SCALE (AO2)

Economies of scale enable a business to benefit from lower average costs (the cost per unit) by increasing the size of its operations. Hence, these are often described as the cost-saving benefits enjoyed by a firm as it grows.

However, **diseconomies of scale** will occur if the firm grows beyond its ability to operate efficiently. This causes the firm's average costs of production to rise due to problems such as miscommunication, misunderstandings, and poor (inefficient) management of resources.

- Joint ventures are generally cheaper than M&As, which involve high legal and administrative costs. It is also quicker to form a JV than to go through with a merger or acquisition.
- The parent companies can enjoy the benefits of growth without losing their individual corporate identities. At the same time, the JV can also create synergies from working with a partner company (such as the transfer of specialist skills), thus strengthening the position of both firms in the market.
- For international joint ventures, the partner company can provide local knowledge to cope with any problems related to cultural differences and business etiquette in overseas markets.

Disadvantages of joint ventures

- As with all forms of partnerships with other entities, there are possible conflicts and disagreements between the parent companies. This might be due to different organizational cultures and management styles. This can create communication and productivity problems, thus jeopardising the joint venture.
- In the case of poor performance, a joint venture is more difficult to terminate than a strategic alliance. This is partly due to the legally binding responsibilities committed by the parent companies of the joint venture.
- Many joint ventures are short-lived as they do not succeed or are purchased outright by one of the parent companies.
- For joint ventures that do succeed, the parent companies have to share the profits.

Strategic Alliances (AO3)

Strategic alliances are created when two or more organizations join together to benefit from external growth *without* having to set up a new separate entity or to make major changes to their own business models. Examples include:

- Apple and MasterCard (the first credit card company to offer Apple Pay)
- Google and Luxottica (high technology for premium quality eyewear products)
- General Motors and Lyft (a strategic alliance set up to develop a driverless car)
- **Spotify and Uber** (riders can listen to their own playlists)
- Star Alliance (one of the largest airline alliances consisting of 27 airlines)
- Starbucks and PepsiCo (bottling, distributing and selling Frappuccino coffee)
- Tata Coffee and Starbucks (coffee retailer / cafe operators in India).

Key Terms

- An **acquisition** involves one company buying a controlling interest (majority stake) in another company based on mutual agreement.
- **Brand acquisition** is the process of taking over another firm's brands rather than the entire company.
- **Franchising** is a growth method that involves the franchisor giving the licensing rights to a franchisee to sell goods and services using the franchisor's brands and trademarked products.
- A **joint venture (JV)** is an external growth method that involves two or more organizations agreeing to create a new business entity, usually for a finite period of time.
- A **merger** is similar but the two companies agree to form a single, larger company thereby benefiting from operating on a larger scale. By contrast, takeovers are almost always hostile in nature.
- A **strategic alliance** is created when two or more organizations join together to benefit from external growth *without* having to set up a new separate entity or to make major changes to their own business models.
- A **takeover (or hostile takeover)** involves one company buying a controlling interest (majority stake) in another company against the wishes of the target company.

Reasons for businesses to grow or to stay small (AO3)

Businesses operating in different markets have varying optimal sizes. For example, a multinational clothes retailer, such as ZARA, will want to expand its operations in retail outlets and shopping malls across the globe. By contrast, some businesses prefer to operate in niche markets selling specialised products to a small market segment, such as a sole trader selling Tae Kwon Do sports equipment to martial arts enthusiasts in Hong Kong.

Business organizations vary in size, and this can be measured in several different ways:

- Sale turnover
- Market share
- Gross profit
- Profit after interest and tax
- Number of customers
- Number of employees
- Number of retail outlets or stores
- Market capitalisation (value of the business).

Reasons for businesses to grow (AO3)

A common **business objective** of many organizations is growth. McDonald's, for example, is the world's largest fast-food restaurant as measured by sales revenue and strives to grow in order to maintain or increase its market share, sales revenues, profits, and shareholder value.
Reasons for the pursuit of business growth include:

- *Economies of scale* - Large organizations benefit from economies of scale (cost-saving benefits of operating on a larger scale). This reduces their unit costs of production, so the large firm is in a position to charge lower prices to their customers, yet be able to offer more choice for their customers. This makes larger firms more competitive and attractive to customers. For example, the Volkswagen group gains economies of scale in the production of components for the various divisions it owns brands, including Audi, Bentley, Bugatti, Lamborghini, and Porsche.

- *Sources of finance* - Large organizations have greater access to a wider range of sources of finance, such as share issues and the ability to borrow funds at a cheaper rate due to their reputation and size. Having more sources of finance can enable these organizations to become even larger as they pursue their growth objectives.

- *Recruitment and retention of employees* - Larger organizations tend to be able to pay their workers higher wages and salaries. This will help to attract and retain better skilled workers, thereby improving the larger firm's productivity and profitability in the long-term.

- *Brand awareness and brand loyalty* - Customers are generally attracted to well-known brands of larger companies, due to brand recognition and brand loyalty. The power of branding suggests that customers trust well-established brand names and are prepared to pay a premium price for them. In many cases, larger firms have the resources to provide better customer services, such as after-sales care.

- *Spreading risks* - Large organizations tend to be less of a risk for the owners, investors and creditors (such as banks and suppliers). By contrast, smaller firms are far more likely to fail, so are a higher risk for owners, investors and creditors. For example, small organizations are more at risk of failing during a recession.

Reasons for businesses to stay small (AO3)

There are reasons for businesses to choose to stay with small organizations, i.e., benefits of not growing. Not all organizations want to grow or evolve. Many organizations prefer to remain small as the owners do not want the additional costs, challenges, and pressures associated with growing their business or operating on a larger scale. Many businesses actually prefer to serve a smaller number of familiar or loyal customers. For example, some law firms or accounting firms specialise in serving the needs of local businesses.