Course: Fundamentals of Business (8402)
Semester: Autumn, 2021

ASSIGNMENT No. 1

Q. 1 Explain why people are willing to be entrepreneurs, even though they might potentially lose all the money that they invest in the business.

Every entrepreneur and small business owner has a different reason for wanting to start their own business. That means that you and every other entrepreneur are deciding to take different risks specific to your idea. However, the actual reason why entrepreneurs decide to take risks can be narrowed down to the following five reasons.

1. You will never know unless you try

Nobody can really be sure if risks will pay off, no matter how calculated they may be. But this should not stop you from taking risks. If you want your business to succeed, risks are necessary. According to a quote by Frederick Wilcox, "Progress always involves risks. You can't steal second base and keep your foot on first."

You don't know how the future will play out or if your business will be successful. However, you can plan ahead to help mitigate the potential for failure. Developing a business strategy, exploring financial scenarios, and revisiting initial performance are just a few ways to help you navigate the unknown. You'll never know unless you try, and you can at least set yourself up to handle different situations.

2. You learn from taking risks

Some risks may not pay off, but an optimistic risk-taker will always look at failure as an opportunity to learn. Social Media Examiner owner Michael Stelzner writes that the willingness to experiment with new ideas is key to business growth. As he puts it, "nothing ventured, nothing gained."

Failure will teach you how to think and plan strategically. Just remember that not all risks are good ones, and when you fail, learn from it and adjust your strategy. In fact, this type of thinking should become integrated within the way you do business. Whether you succeed, fail or land somewhere in the middle, it's important to have a system in place that helps you analyze that performance.

3. Innovation and opportunity are tied to risk

Innovation involves changing how people do things. Combine that with the fact that customers have constantly changing demands and you have consistent opportunities for new business. It is about sharing and teaching what we know and putting new ideas into practice as a constant state of progress.

Business leaders accept risk as a cost of opportunity and innovation. They know it cannot happen if you will not accept the risk that your undertaking might fail. The level of risk may be lessened, however, if you make all possible calculations and evaluate which options are best before proceeding to the next step. The more clearly you can validate your idea or a specific direction, the more likely you are to succeed even if it's risky.

4. Those who take risks already have a competitive advantage

Since most people tend to avoid risk, those who are brave enough to take risks already have a competitive advantage. Similar to the concept of a first-mover advantage, when most individuals stay away from risk, that means less competition for risk-takers. This means if you've found a worthwhile opportunity, and no one else has jumped on it, you're the only business reaping the benefits and communicating with customers.

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So anytime you're considering taking a risk, keep your competitors in mind. If you don't take the risk they may opt to do so instead. But as long as you understand the potential return, you can rest assured knowing whether it's a worthwhile risk or not.

5. Risk-takers may be more content and satisfied with their lives

Most people are not willing to take risks, but a study on risk-taking revealed that there is a link between willingness to take risks and personal satisfaction. You won't look back and dwell on what could have been or the fear you felt when facing uncertainty. Instead, you know what was on the other side of that "what-if" scenario and can feel proud of the fact that you were willing to take risks to grow your business.

Now again this doesn't mean you take risks at every turn but instead take calculated risks that have been thoroughly considered. Avoiding unnecessary risks and saying no to new ones based on past experiences can be just as satisfying. Finding the right balance and taking risks when it makes sense, even if there's a chance of failure, is a sure way to find success and satisfaction.

Risk is often used as a blanket term when describing decisions made under various levels of uncertainty. But keeping the concept of risk so broad doesn't do you or your business any favors when trying to navigate and make decisions. Instead, you want to understand the type of risk you are taking and how it can affect your business.

Here are the different types of risk you can expect to face as a business owner:

Market risk

Market risk, also known as systemic risk, refers to the risk of loss due to fluctuations in the market. To mitigate this risk, an entrepreneur should develop and implement various strategies that inform you of potential changes or disruptions.

Known as a market analysis, it's a process that allows you to explore potential opportunities, challenges, and preferences. The end result should help you better understand your audience, the available market, and if you need to pivot the focus of your product or service.

Competitive risk

Competitive risk refers to the chance that direct or indirect competition impacts the revenue or margins of your business. This is often due to competitive advantages in product specifications, price, or marketing strategy.

This type of risk is higher for startups since they usually face competition with companies that have established their presence in the market several years prior. An entrepreneur can minimize this risk by conducting a SWOT analysis and come up with strategies to counter their competitors.

Credibility risk

Credibility risk refers to the risk that an entrepreneur faces when putting out a new product or service in the market. The credibility of a brand name helps greatly in establishing a business and can influence the purchasing decisions of potential customers.

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According to a study, approximately 59 percent of consumers prefer to buy new products from brands that they are familiar with, and 21 percent report they bought a new product because it was from a brand they like.

To mitigate credibility risk, there are several strategies to consider. These include building a professional online presence via your business's website and social media accounts, focusing on quality products and services, and avoiding questionable business deals.

Technology risk

Technology risk refers to the risk of losses that business owners face due to technology failures. For example, lost revenue due to the crash of your eCommerce website, a security breach resulting in the theft of customer data, or failing to transition employees to working remotely due to a lack of available tools.

The best way to minimize this risk is to invest in up-to-date technology that is both affordable and reliable. Regular maintenance and security checks should be done to ensure that everything is running smoothly and all customer data is protected. Additionally, being sure to listen to your employee's needs and how a lack of tools or resources is leading to issues or failures can help you avoid unnecessary problems.

Financial risk

Financial risk refers to the risk that the company's cash flow will not be sufficient to meet its financial obligations. This is easily the biggest concern for most business owners as cash flow defines the health and stability of your business.

This risk isn't just limited to a lack of sales or higher operational costs, it also includes your funding sources. You'll need to be careful when selecting investors and determine if the rate of return and stake in your business is reasonable for the amount of funding.

You'll need to actively manage, adjust, and forecast your financial risk as this will be the most direct and consistent risk for your business.

Q. 2 How can tying employee compensation to a firm's performance resolve some conflicts of interest?

Tying compensation to performance can be a tricky and slippery slope for employers to travel down. Companies that want to enact a program like this need to be aware of the common pitfalls and do their best to build a program that helps avoid them. If you're considering doing this, take into account the following dangers.

It Hurts Team Collaboration

Team members anxious to improve their performance may avoid working with others they perceive to be less able, which ultimately will exclude many employees from the more rewarding projects. Keen competition for limited rewards can create a hostile environment, in which trust and cooperation are sacrificed in the interest of self-promotion. There must be a good balance between individual competition and team dynamics.

It Increases Employee Conflict

When competition is introduced in the workplace, it's sometimes difficult to maintain positive workplace relationships. Time after time employers try out new methods to increase productivity, but what is the real cost? For the individual whose only goal is to make it to the top, they will forego all workplace formalities and do

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whatever they can to reach their goal. Workplace relationships suffer when compensation is involved directly, and the best way to receive better compensation is to beat out all your friends and colleagues.

Its Difficult to Evaluate Performance Objectively

Aside from the negative impact on employee relations, the company may also suffer from trying to implement a compensation-based performance method. Since performance evaluations can be highly subjective, depending on the relationship between an employee and his or her supervisor, enforcing a system of tying compensation to pay can introduce inequities that are counter-productive for the organization as a whole.

Reasons for Rewards are Ignored

A commission system might lead a manager to blame an employee when he or she doesn't meet quotas, when the real problem may be inherent in the organization. Thus, tying compensation to performance might end up hurting your top talent and the organization as a whole. Other factors outside of the employee's control, such as an underperforming marketing department, might be the real reason for a lower performance. If an employee is blamed for this kind of problem, he or she might not stay for long.

It Decreases Risk-Taking

If compensation is tied to performance, employees will be less likely to take risks because their paycheck could suffer. This will take away from your company's ability to foster a creative and innovative environment. People will be less likely to pursue hunches and take risks because they'll be afraid that they won't make as much money. In a compensation-based performance model, taking chances can essentially be non-existent.

In order for a company to successfully implement the method of tying compensation to performance, it must create reasonable, achievable, and measurable goals that can be reached by any employee in the organization. And the program must be comprehensive enough to include carefully monitoring and accurately assessing the success of each employee.

Q. 3 What are the two basic determinants of market prices? How are shortages and surpluses corrected in the marketplace?

Price is dependent on the interaction between demand and supply components of a market. Demand and supply represent the willingness of consumers and producers to engage in buying and selling. An exchange of a product takes place when buyers and sellers can agree upon a price.

This section of the Agriculture Marketing Manual explains price in a competitive market. When imperfect competition exists, such as with a monopoly or single selling firm, price outcomes may not follow the same general rules.

Equilibrium price

When a product exchange occurs, the agreed upon price is called an equilibrium price, or a market clearing price. Graphically, this price occurs at the intersection of demand and supply as presented in Image 1.

In Image 1, both buyers and sellers are willing to exchange the quantity Q at the price P. At this point, supply and demand are in balance. Price determination depends equally on demand and supply.

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It is truly a balance of the market components. To understand why the balance must occur, examine what happens when there is no balance, such as when market price is below that shown as P in Image 1.

At any price below P, the quantity demanded is greater than the quantity supplied. In such a situation, consumers would clamour for a product that producers would not be willing to supply; a shortage would exist. In this event, consumers would choose to pay a higher price in order to get the product they want, while producers would be encouraged by a higher price to bring more of the product onto the market.

The end result is a rise in price, to P, where supply and demand are in balance. Similarly, if a price above P were chosen arbitrarily, the market would be in surplus with too much supply relative to demand. If that were to happen, producers would be willing to take a lower price in order to sell, and consumers would be induced by lower prices to increase their purchases. Only when the price falls would balance be restored.

A market price is not necessarily a fair price, it is merely an outcome. It does not guarantee total satisfaction on the part of buyer and seller. Typically, some assumptions about the behaviour of buyers and sellers are made, which add a sense of reason to a market price. For example, buyers are expected to be self-interested and, although they may not have perfect knowledge, at least they will try to look out for their own interests. Meanwhile, sellers are considered to be profit maximizers. This assumption limits their willingness to sell to within a price range, high to low, where they can stay in business.

Change in equilibrium price

When either demand or supply shifts, the equilibrium price will change. The section on understanding supply factors explains why a market component may move. The examples below show what happens to price when supply or demand shifts occur.

Example 1: Unusually good weather increases output

When a bumper crop develops, supply shifts outward and downward, shown as S2 in Image 2, more product is available over the full range of prices. With no immediate change in consumers' willingness to buy crops, there is a movement along the demand curve to a new equilibrium. Consumers will buy more but only at a lower price. How much the price must fall to induce consumers to purchase the greater supply depends upon the elasticity of demand.

In Image 2, price falls from P1 to P2 if a bumper crop is produced. If the demand curve in this example was more vertical (more inelastic), the price-quantity adjustments needed to bring about a new equilibrium between demand and the new supply would be different.

To understand how elasticity of demand affects the size of adjustment in prices and quantities when supply shifts, try drawing the demand curve (or line) with a slope more vertical than that depicted in Image 2. Then compare the size of price-quantity changes in this with the first situation. With the same shift in supply, equilibrium change in price is larger when demand is inelastic than when demand is more elastic.

The opposite is true for quantity. A larger change in quantity will occur when demand is elastic compared with the quantity change required when demand is inelastic.

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A decline in the preference for beef is one of the factors that could shift the demand curve inward or to the left, as seen in Image 3.

With no immediate change in supply, the effect on price comes from a movement along the supply curve. An inward shift of demand causes price to fall and also the quantity exchanged to fall. The amount of change in price and quantity, from one equilibrium to another, is dependent upon the elasticity of supply.

Imagine that supply is almost fixed over the time period being considered. That is, draw a more vertical supply curve for this shift in demand. When demand shifts from D1 to D2 on a more vertical supply curve (inelastic supply) almost all the adjustment to a new equilibrium takes place in the change in price.

Price stability

Two forces contribute to the size of a price change: the amount of the shift and the elasticity of demand or supply. For example, a large shift of the supply curve can have a relatively small effect on price if the corresponding demand curve is elastic. That would show up in Example 1 above, if the demand curve is drawn flatter (more elastic).

In fact, the elasticity of demand and supply for many agricultural products are relatively small when compared with those of many industrial products. This inelasticity of demand has led to problems of price instability in agriculture when either supply or demand shifts in the short-term.

Price level

The two examples above focus on factors that shift supply or demand in the short-term. However, longer-term forces are also at work, which shift demand and supply over time. One particular supply shifter is technology. A major effect of technology in agriculture has been to shift the supply curve rapidly outward by reducing the costs of production per unit of output.

Technology has had a depressing effect on agricultural prices in the long-term since producers are able to produce more at a lower cost. At the same time, both population and income have been advancing, which both tend to shift demand to the right. The net effect is complex, but overall the rapidly shifting supply curve coupled with a slow moving demand has contributed to low prices in agriculture compared to prices for industrial products.

At various levels of a market, from farm gate to retail, unique supply and demand relationships are likely to exist. However, prices at different market levels will bear some relationship to each other. For example, if hog prices decline, it can be expected that retail pork prices will decline as well. This price adjustment is more likely to happen in the long-term once all participants have had time to adjust their behaviour.

In the short-term, price adjustments may not occur for a variety of reasons. For example, wholesalers may have long-term contracts that specify the old hog price, or retailers may have advertised or planned a feature to attract customers.

Q. 4 Identify and briefly describe the foreign characteristics that can influence international business investments.

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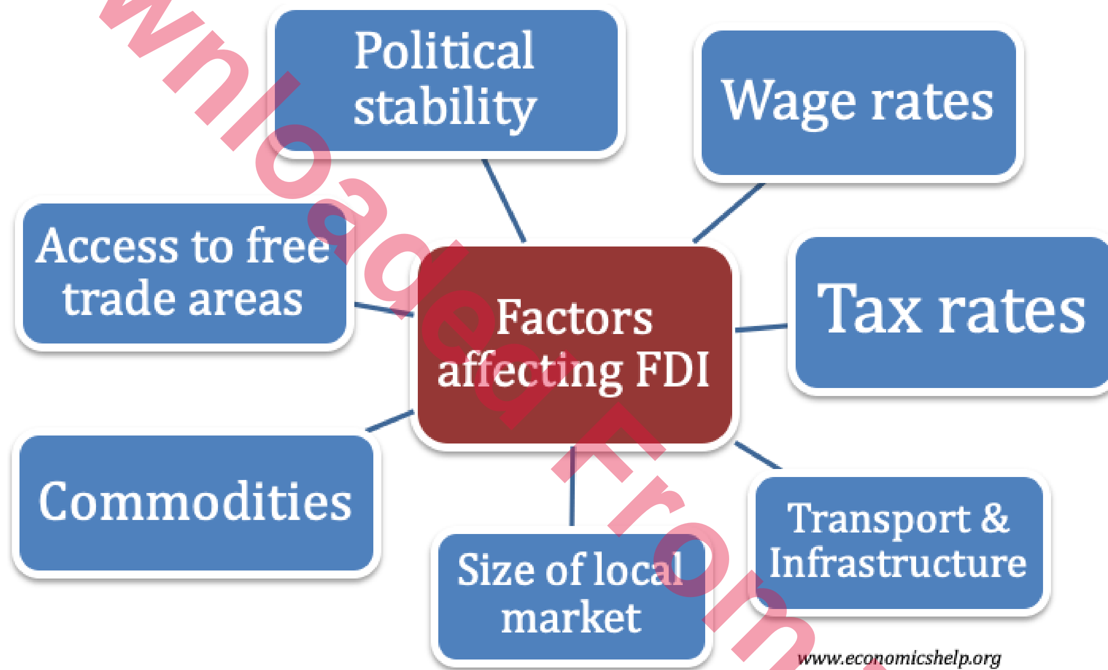
Foreign direct investment (FDI) means companies purchase capital and invest in a foreign country. For example, if a US multinational, such as Nike built a factory for making trainers in Pakistan; this would count as foreign direct investment.

In summary, the main factors that affect foreign direct investment are

- Infrastructure and access to raw materials
- Communication and transport links.
- Skills and wage costs of labour



1. Wage rates

A major incentive for a multinational to invest abroad is to outsource labour-intensive production to countries with lower wages. If average wages in the US are $15 an hour, but $1 an hour in the Indian sub-continent, costs can be reduced by outsourcing production. This is why many Western firms have invested in clothing factories in the Indian sub-continent.

- However, wage rates alone do not determine FDI, countries with high wage rates can still attract higher tech investment. A firm may be reluctant to invest in Sub-Saharan Africa because low wages are outweighed by other drawbacks, such as lack of infrastructure and transport links.

2. Labour skills

Some industries require higher skilled labour, for example pharmaceuticals and electronics. Therefore, multinationals will invest in those countries with a combination of low wages, but high labour productivity and skills. For example, India has attracted significant investment in call centres, because a high percentage of the population speak English, but wages are low. This makes it an attractive place for outsourcing and therefore attracts investment.

3. Tax rates

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Large multinationals, such as Apple, Google and Microsoft have sought to invest in countries with lower corporation tax rates. For example, Ireland has been successful in attracting investment from Google and Microsoft. In fact, it has been controversial because Google has tried to funnel all profits through Ireland, despite having operations in all European countries.

4. Transport and infrastructure

A key factor in the desirability of investment are the transport costs and levels of infrastructure. A country may have low labour costs, but if there is then high transport costs to get the goods onto the world market, this is a drawback. Countries with access to the sea are at an advantage to landlocked countries, who will have higher costs to ship goods.

5. Size of economy / potential for growth

Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for economic growth will be important for attracting investment. For example, Eastern European countries, with a large population, e.g. Poland offers scope for new markets. This may attract foreign car firms, e.g. Volkswagen, Fiat to invest and build factories in Poland to sell to the growing consumer class. Small countries may be at a disadvantage because it is not worth investing for a small population. China will be a target for foreign investment as the newly emerging Chinese middle class could have a very strong demand for the goods and services of multinationals.

6. Political stability / property rights

Foreign direct investment has an element of risk. Countries with an uncertain political situation, will be a major disincentive. Also, economic crisis can discourage investment. For example, the recent Russian economic crisis, combined with economic sanctions, will be a major factor to discourage foreign investment. This is one reason why former Communist countries in the East are keen to join the European Union. The EU is seen as a signal of political and economic stability, which encourages foreign investment.

Related to political stability is the level of corruption and trust in institutions, especially judiciary and the extent of law and order.

7. Commodities

One reason for foreign investment is the existence of commodities. This has been a major reason for the growth in FDI within Africa – often by Chinese firms looking for a secure supply of commodities.

8. Exchange rate

A weak exchange rate in the host country can attract more FDI because it will be cheaper for the multinational to purchase assets. However, exchange rate volatility could discourage investment.

9. Clustering effects

Foreign firms often are attracted to invest in similar areas to existing FDI. The reason is that they can benefit from external economies of scale – growth of service industries and transport links. Also, there will be greater confidence to invest in areas with a good track record. Therefore, some countries can create a virtuous cycle of

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attracting investment and then these initial investments attracting more. It is also sometimes known as an agglomeration effect.

10. Access to free trade areas.

A significant factor for firms investing in Europe is access to EU Single Market, which is a free trade area but also has very low non-tariff barriers because of harmonisation of rules, regulations and free movement of people. For example, UK post-Brexit is likely to be less attractive to FDI, if it is outside the Single Market.

Evaluation

There are many different factors that determine foreign direct investment (FDI) and it is hard to isolate individual factors, given there are many different variables. It also depends on the type of industry. For example, with manufacturing FDI, low wage costs tend to be the most important, as they are a labour-intensive industry. For the service sector, FDI, macro-economic stability and political openness tend to be more important.

Q. 5 Discuss the advantages and disadvantages of starting your own business compared to buying a franchise.

In a franchise business, the franchisor provides a developed way of doing business, ongoing guidance, systems and assistance in return for periodic payment of fees and/or purchases.

Buying a franchise can be a viable alternative to starting your own business. Listed below are some advantages and disadvantages of buying a franchise.

- Franchises offer the independence of small business ownership supported by the benefits of a big business network.
- You don't necessarily need business experience to run a franchise. Franchisors usually provide the training you need to operate their business model.
- Franchises have a higher rate of success than start-up businesses.
- You may find it easier to secure finance for a franchise. It may cost less to buy a franchise than start your own business of the same type.
- Franchises often have an established reputation and image, proven management and work practices, access to national advertising and ongoing support.
- Buying a franchise means entering into a formal agreement with your franchisor.
- Franchise agreements dictate how you run the business, so there may be little room for creativity.
- There are usually restrictions on where you operate, the products you sell and the suppliers you use.
- Bad performances by other franchisees may affect your franchise's reputation.
- Buying a franchise means ongoing sharing of profit with the franchisor.
- Franchisors do not have to renew an agreement at the end of the franchise term.

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Franchising is seen by many as a simple way to go into business for the first time. But franchising is no guarantee of success and the same principles of good management—such as informed decision-making, hard work, time management, having enough money and serving your customers well—still apply.

Be cautious when buying into a franchise if you have to develop the market and the brand in your designated area. Make sure your investment generates healthy returns and a capital gain when you sell.

Five Advantages of Buying a Franchise

- **Much of the work needed to launch a business idea has already been done.** Products and services will have been established and tested. This includes already recognized branding and trademarks. The franchisor will also have a good idea of what locations and demographics work best for their system.
- **Not as much, if any, experience is needed to start.** Training provided by the franchisor will help franchisees gain or bolster the skills required to operate the franchise. Many franchisors also offer additional training at the franchisee's request.
- **Support from a larger network of businesses.** Not only does the franchisor give you support in the form of training, an operations manual for you to refer to, and additional ongoing advice, you can also get support from other franchisees in the network. Annual conventions or meetings are a common occurrence for franchises.
- **Ability to tap into the collective buying power of the franchisor.** In many cases, the franchisor has developed relationships with providers that allow its franchisees to purchase goods at a lower cost compared to the price independent owners of a similar business may be able to negotiate for themselves.
- **In cases, financing may be easier to secure.** Banks and other lenders are sometimes more apt to loan money to those looking to buy a franchise because of an existing knowledge of the franchisor's product or service.

Five Disadvantages of Buying a Franchise

- **Less flexibility than running a business on your own.** Some franchisors exert a level of control that you may find too restricting. Franchisees often have restrictions on where they can sell their products or services, as well as requirements on the suppliers to be used or operating hours.
- **Except in rare instances, you must share profits with franchisor.** Royalties, a fee established for the continued use of the franchisor's trademarks and patented processes, typically will need to be paid to the franchisor regularly. However, there are franchises that don't require royalty payments.
- **Set rates for certain business expenditures.** For example, you would have to spend money on advertising or technology for any business you run, but in a franchise relationship these costs are set by the franchisor. There's no deviation for your personal situation or preferences.

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- **Business reputation is somewhat dependent on others who also run the same franchise.** If another franchisee in the system performs poorly, it may lead potential customers to not give your business a chance.
- **Franchisors, by and large, hold the majority of the renewal power.** Most franchisors, if they offer renewal rights, will renew a franchise if the franchisee is in good standing. However, this status is at their discretion. Good standing is often determined by a set of requirements outlined in the franchise agreement. Common requirements for renewal include giving the franchisor ample notice of the desire to extend, payment of a renewal fee, making updates to the premises if there is a physical location, among other things.

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