Unit 1
Module 1

Business and its environment

Types of economic activity

Objectives

At the end of this section you will be able to:

1. **Define the primary sector, secondary sector and tertiary sector of an economy**
2. **Distinguish between the various economic sectors of the economy.**

Introduction

Economic activity can be classified as primary, secondary and tertiary.

In underdeveloped economies their economic activity is essentially primary production.

In developing economies primary production is still a large part of the economic activity. However, the secondary level of production begins to develop. The tertiary level is very small.

In developed economies all sectors are developed, especially the tertiary sector. There exist therefore backward and forward linkages between economic growth and development.

The primary sector

The primary sector is that part of the economy that is involved in the production of raw materials or the extraction of raw materials from the land. The primary sector includes agriculture, fishing, forestry, mining and quarrying. It is an important sector contributing to the economic gross national product.

Gross national product (GNP): this is the value of output produced within a country plus net property income from abroad. Gross domestic product plus net income from abroad equals gross national product.

The secondary sector

This sector includes all firms that convert raw materials into finished goods. In developing economies, this sector grows faster than the primary sector. It contributes to increasing employment, improvement in the balance of payment and an improvement in people's standard of living.

The tertiary sector

The tertiary sector is that part of the economy where the firms provide services to consumers and businesses.

Examples include banking, transport, insurance, tourism.

An increase in the size of this sector is evident as an economy develops.

QUICK TEST

1. **Define the following:**
   a. Primary sector **[5 marks]**
   b. Secondary sector **[5 marks]**
   c. Tertiary sector **[5 marks]**
2. **Account for the size of various primary sectors in undeveloped and developing economies.** **[15 marks]**

Economic sectors and legal structures

Objectives

At the end of this section you will know:

1. **Organisations that exist in the private and public sectors**
2. **The advantages and disadvantages of each organisation**
3. **The legal structure of each organisation**
4. **How they raise finance.**

Legal structure of the firm

There are two broad categories of business:

1. **Incorporated**
2. **Unincorporated**

Incorporated business

- **An incorporated business has a legal identity that is separate from the individual owners.**
- **The private sector includes: private limited companies (Ltd.), public limited companies (PLCs), cooperatives and friendly societies.**
- **These firms can own assets, owe money, and enter into contracts in their own right as they are recognised legally as a separate entity.**
- **They have limited liability.**

Unincorporated business

- **In an unincorporated business, there is no distinction in the law between the owners and the business itself.**
- **These businesses include sole traders and partnerships.**
- **Liability is unlimited.**

Private sector organisations

Sole trader

The features of a sole trader are:

- **A sole trader is a one-man business.**
- **Owner provides all the capital.**
- **Owner provides all the labour.**
- **Unlimited liabilities.**
- **Owner undertakes all the risks.**
- **Owner enjoys all the profits.**
- **Owner makes all the decisions.**
- **Owner suffers all the losses.**

The advantages and disadvantages of a sole trader are set out below.

Advantages and disadvantages of sole trader	
Advantages	**Disadvantages**
› Easy to form	› Limited capital
› There is a closer relationship with customers	› Expansion is restricted because of lack of capital
› Owner can react immediately to customers' needs	› Does not benefit from economies of scale
› Owner is flexible; decision-making is quick	› Legal requirements, e.g. completing VAT records puts additional strain on owner
› Owner is motivated to work hard, as he is working for himself	› Owner cannot easily take a holiday
› Profits are not shared	› When owner dies the business usually dies with him
› Unlimited liability means owner is careful in making decisions	› Unlimited liability; if owner cannot pay debt he may lose personal assets as well as the business
› Secrecy is maintained	
› Can compete with larger firms because they are located in rural areas, where larger firms will not locate	

Partnership

Features of a partnership include:

- **A partnership is a legal agreement.**
- **Consists of two or more individuals.**
- **Not a separate legal unit.**
- **A Deed of Partnership may be drawn up, but it is not a legal requirement.**

Partnerships are common among professionals, for example lawyers.

The advantages and disadvantages of a partnership are set out below.

Advantages and disadvantages of partnership	
Advantages	**Disadvantages**
› Simple to establish, i.e. not much legal procedure	› Personal unlimited liability
› Each partner contributes capital; more than a sole trader	› Decision-making can be slower because of the number of partners
› Greater economies of scale can be achieved	› A decision made by one partner is binding on the rest of the partners
› New ideas, as there are more partners	› Disagreement among partners
› There is specialisation, i.e. partners can specialise in a given area	› Insufficient capital; this hinders growth and expansion
› There are shared responsibilities	
› Decision-making can be more effective	› Profits are shared among partners
› Less personal stress than the sole trader	
› Continuity: if a partner dies their share of the business can be purchased by other partners	
› Easy to expand	

Private limited company

Features of a private limited company include:

- **It consists of two to fifty shareholders.**
- **It is governed by:**
  - **Memorandum of Association, which governs the external relationship of the company.**
  - **The Articles of Association, which governs the internal affairs of the business.**
- **It enjoys limited liabilities.**
- **The letters 'Co. Ltd.' must be included after the company's name.**

The advantages and disadvantages of a private limited company are set out below

Advantages and disadvantages of private limited company	
Advantages	**Disadvantages**
› Shareholders have limited liability	› Legal formalities are involved in setting up the firm
› If a shareholder dies the business continues	› Capital is limited as shares cannot be sold on the open market
› It is a separate legal personality	› Shares are not easily transferable
› It can raise more capital from the sale of shares to employees, friends, family	› Limited contact with employees
› Economies of scale	
› Division of labour	
› Risks are spread among shareholders	

Public limited company

Features of a public limited company include:

- **Stocks are sold to the public on the Stock Exchange.**
- **The letters PLC must be included after the company's name.**
- **Shares are transferable.**

Limited liability: this is a concept that states shareholders of a firm are financially responsible for the amount of money they have invested in the firm. It means that should the firm become insolvent, shareholders will lose only the funds they have invested in the firm and not their personal assets.

The advantages and disadvantages of a public limited company are set out below.

Advantages and disadvantages of public limited company	
Advantages	**Disadvantages**
› It is a separate legal entity	› Legal formalities are required in setting up the firm. High cost to the firm
› Limited liability for business debts	› Legal requirements: information must be disclosed to shareholders and the public
› Continuity	› Over-expansion can lead to diseconomies of scale
› Shares can be easily bought and sold	› There is the possible risk of a takeover as shares are sold on the open market
› Has access to more capital as shares can be sold on the open market	› The objectives of managers may be different from shareholders
› Enjoys the benefits of economies of scale	
› Risks are spread over many shareholders	

Cooperative enterprise

Features of a cooperative enterprise include:

- **All members contribute to the running of the business, e.g. share workload, responsibilities, and decision-making.**
- **All members have one vote.**
- **Profits are shared equally among members.**
- **Limited liabilities.**

The advantages and disadvantages of a cooperative enterprise are set out below.

Advantages and disadvantages of cooperative enterprise	
Advantages	**Disadvantages**
› It is democratically merged	› There is a lack of business experience
› There is no conflict of interest	› Lack of capital as shares cannot be sold on the open market
› High level of motivation among members	› Slow decision-making
› Gain benefits from buying in bulk	› It is owned and managed by its members, who may not have the necessary skills and training. They may be less efficient and therefore face competition from larger firms

Franchise

Features of a franchise include:

- **It is not strictly a legal structure.**
- **It is a legal contract between two firms.**

The advantages of a franchise to the franchisor and franchisee are set out below.

Advantages of a franchise	
Advantages to the franchisor	**Advantages to the franchisee**
› It reduces their cost of operation	› They can start a business that is already established
› It increases their market share	› Their advertising cost is reduced
› The established standards are maintained	› Training for staff borne by parent company
› It increases their cash flow; payment for the 'rights' and royalties as the firm operates	