# Chapter 2: Types of business activity

**Levels of economic activity**

In order for products to be made and sold to the people, it must undergo 3 different production processes. Each process is done by a different **business sector** and they are:

- **Primary sector:** The natural resources extraction sector. E.g. farming, forestry, mining… (earns the least money)
- **Secondary sector:** The manufacturing sector. E.g. construction, car manufacturing, baking… (earns a medium amount of money)
- **Tertiary sector:** The service sector. E.g banks, transport, insurance…(earns the most money)

Importance of a sector in a country:

- no. of workers employed.
- value of output and sales.

**Industrialisation:** a country is moving from the primary sector to the secondary sector.
**De-industrialisation:** a country is moving from the secondary sector to the tertiary sector.
In both cases, these processes both earn the country more revenue.

**Types of economiess**

**Free market economy:**
All businesses are owned by the **private sector**. **No** government intervention.

Pros:

- Consumers have a lot of **choice**
- High **motivation** for workers
- **Competition** keeps prices low
- **Incentive** for other businesses to set up and make profits

Cons:

- Not all products will be available for everybody, especially the **poor**
- No government intervention means **uncontrollable** economic booms or recessions
- **Monopolies** could be set up limiting consumer choice and exploiting them

**Command/Planned economy:**
All businesses are owned by the **public sector**. **Total** government intervention. Fixed wages for everyone. Private property is not allowed.

Pros:

- **Eliminates** any **waste** from competition between businesses (e.g. advertising the same product)
- **Employment** for everybody
- All **needs** are met (although no luxury goods)

Cons:

- **Little motivation** for workers

- The government might produce things people **don't** want to buy
- **Low incentive** for firms (no profit) leads to low efficiency

**Mixed economy:**
Businesses belong to both the private and public sector. Government controls **part**of the economy.

**Industries under government ownership:**
- health
- education
- defence
- public transport
- water & electricity

**Privatisation**
Privatisation involves the government selling national businesses to the private sector to increase output and efficiency.

Pros:
- New **incentive** (profit) encourages the business to be more efficient
- **Competition** lowers prices
- Individuals have more **capital** than the government
- Business decisions are for **efficiency**, not **government popularity**
- Privatisation **raises money** for the government

Cons:
- **Essential** businesses making losses will be **closed**
- Workers could be made **redundant** for the sake of profit
- Businesses could become **monopolies**, leading to higher price

**Comparing the size of businesses**
Businesses vary in size, and there are some ways to measure them. For some people, this information could be very useful:
- Investors - how safe it is to invest in businesses
- Government - tax
- Competitors - compare their firm with other firms
- Workers - job security, how many people they will be working with
- Banks - can they get a loan back from a business.

**Ways of measuring the size of a business:**
- **Number of employees.** Does not work on capital intensive firms that use machinery.
- **Value of output.** Does not take into account people employed. Does not take into account sales revenue.
- **Value of sales.** Does not take into account people employed.
- **Capital employed.** Does not work on labour intensive firms. High capital but low output means low effiency.

You **cannot** measure a businesses size by its **profit**, because profit depends on too many factors not just the size of the firm.

**Business Growth**
All owners want their businesses to expand. They reap these benefits:

- Higher profits
- More status, power and salary for managers
- Low average costs (economies of scale)
- Higher market share

**Types of expansion:**

- Internal Growth: **Organic** growth. Growth paid for by owners capital or retained profits.
- External Growth: Growth by **taking over** or **merging** with another business.

**Types of Mergers (and main benefits):**

**- Horizontal Merger:** merging with a business in the same business sector.

- Reduces no. of competitors in industry
- Economies of scale
- Increase market share

**- Vertical merger:**
Forward vertical merger:

- Assured outlet for products
- Profit made by retailer is absorbed by manufacturer
- Prevent retailer from selling products of other businesses
- Market research on customers transfered directly to the manufacturer

Backward vertical merger:

- Constant supply of raw materials
- Profit from primary sector business is absorbed by manufacturer
- Prevent supplier from supplying other businesses
- Controlled cost of raw materials

**Conglomerate merger:**

- Spreads risks
- Transfer of new ideas from one section of the business to another

**Why some businesses stay small:**
There are some reasons why some businesses stay small. They are:

- **Type of industry the business is in:** Industries offering personal service or specialized products. They cannot grow bigger because they will lose the personal service demanded by customers. E.g. hairdressers, cleaning, convenience store, etc.
- **Market size:** If the size of the market a business is selling to is too small, the business cannot expand. E.g. luxury cars (Lamborghini), expensive fashion clothing, etc.
- **Owners objectives:** Owners might want to keep a personal touch with staff and customers. They do not want the increased stress and worry of running a bigger business.