



OPEN EDUCATIONAL RESOURCES

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OPEN SCHOOLS

Taking Education to the People



Open Educational Resources (OER) for Open Schooling

The Commonwealth of Learning (COL) Open Schools Initiative launched an Open Educational Resources (OER) Project to provide materials under the Creative Commons license agreement to support independent study in 17 specially selected secondary school subjects. Funded by the William and Flora Hewlett Foundation its aim is to broaden access to secondary education through the development of high quality Open Distance Learning (ODL) or self-study materials.

These specially selected OER subjects include:

1. Commerce 11
2. Coordinated Science 10 (Biology, Chemistry and Physics)
3. English 12
4. English Second Language 10
5. Entrepreneurship 10
6. Food & Nutrition
7. Geography 10
8. Geography 12
9. Human Social Biology 12
10. Life Science 10
11. Life Skills
12. Mathematics 11
13. Mathematics 12
14. Physical Science 10
15. Physical Science 12
16. Principles of Business
17. Spanish

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The *OER for Open Schooling Teachers' Guide* has been developed to guide teachers/instructors on how to use the Open Educational Resources (OER) in five of these courses.

1. English
2. Entrepreneurship
3. Geography
4. Life Science
5. Physical Science

The aim of this teachers' guide is to help all teachers/instructors make best use of the OER materials. This guide is generic, but focuses on Namibian examples.

Print-based versions are available on CD-ROM and can be downloaded from www.col.org/CourseMaterials. The CD-ROM contains the module and folders with additional resources, multimedia resources and/or teacher resources. Note that not all subjects have multimedia resources.

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Published by:

Commonwealth of Learning
1055 West Hastings, Suite 1200
Vancouver, British Columbia
Canada V6E 2E9
Telephone: +1 604 775 8200
Fax: +1 604 775 8210
Web: www.col.org
Email: info@col.org

The Commonwealth of Learning (COL) is an intergovernmental organisation created by Commonwealth Heads of Government to encourage the development and sharing of open learning and distance education knowledge, resources and technologies.

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Unit 1: Development of Economic Systems

Introduction

How do you make choices about what to eat, what clothes to wear and what to do with your time? Do reasons like your needs, wants, and how much money you have influence the choices you make? Now focus on the country where you live. How are goods and services made available to people? What influences the general population in terms of what goods and services they purchase? Do businesses and government engage in economic activities to make this possible? Or, do individuals make everything they need for themselves? Your answers to these questions will serve to introduce you to the underlying principle of this exciting and interesting business course you are about to embark on, that is, how economic systems operate to provide goods and services to satisfy our needs and wants.

In this unit you will see how people in the early days of civilisation fulfilled their basic needs, and then compare this with how needs and wants are met in our present day world. You will understand why all people, businesses and countries have to make choices and examine how economic activities are organised to produce goods and services. All these economic activities work together to make an economic system.

In Session 1 you will be introduced to some key concepts about economic activities, which will be developed as the course progresses. You will also briefly trace the transition of economic activities from the early days of civilisation to our present time. Sessions 2, 3 and 4 will highlight the main characteristics of different economic systems that exist in our world today, as countries make decisions about production, distribution and use or consumption of goods and services.

Upon completion of this unit you will be able to:



Outcomes

Describe the development of economic activity.

Explain the basic economic problem of scarcity.

Describe the Free, Planned and Mixed economic systems.

Distinguish among various economic systems.

The sessions in this unit are:

Session 1: An Overview of Economic Activity.

Session 2: The Free Enterprise Economic System.

Session 3: The Planned Economic System.

Session 4: The Mixed Economic System.

Time Frame: Twenty hours (20 hours)

Session 1: An Overview of Economic Activity

Introduction

We all have needs and wants, and how they are satisfied will depend on the choices, decisions and actions of individuals, businesses and the government. These decisions and actions comprise the economic activity of a country. Satisfying needs and wants is thus the basis of all economic activity.

In this session you will briefly examine economic activity in the early days of civilisation and compare this with what exists in our present time. You will learn about money and how it facilitates economic activity. You will discover the basic economic problem of scarcity that is common to all persons, businesses and countries.

Upon completion of this session you will be able to:



Outcomes

Describe economic activity of the early days of civilisation.

State the functions of money.

Identify economic activities of the modern day economy.

Relate wants and resources to the basic economic problem of scarcity.

Identify the three resource allocation questions facing all countries.

Define key concepts relevant to economic activities



Terminology

Economic activity:	All processes involved in production, distribution and consumption of goods and services to satisfy needs and wants.
Economic system:	The way in which a community or country organises its economic activities.
Subsistence economic system:	Economic activity where a community produces only enough goods and services to satisfy present needs.
Production:	The creation of goods and services with the power to satisfy needs and wants.
Division of labour:	The subdividing of a production process into different parts or jobs and assigning persons or specialists with the relevant skills to perform each job.
Specialisation:	Concentrating on doing what one is most skilled or best at.



Reflection

Needs and wants

Think of things you need and cannot survive for long without.

You may have identified that you need water and food in order to be healthy, clothes to protect your body and a place to live. That is correct because food, clothing and shelter are traditionally considered to be needs or things required for survival.

Now think of things you want or would like to have but are not absolutely necessary for survival.

Most likely you will have a very long list which includes things we have grown accustomed to, such as vehicles, electronics, books, entertainment and so on.

A closer look at some of the things we believe are needs may reveal that they are actually wants. Let us examine a place to live. Is a large, modern house, equipped with the latest electronic gadgets, a need or a want? Would a person be able to survive in a smaller, simpler house, or even an apartment? Of course they would, because the basic need is for a place to live. However, as society develops, people may desire certain lifestyles for additional comfort and convenience.

Wants are things desired but not essential for survival. Clearly needs and wants are different and over time the distinction has become more difficult to clearly outline. What is a want for one person may be a need for another as the degree of necessity varies for different people and circumstances. For example, you may want a camera to record memorable events, but if you have a career as a photographer you will need a camera to do photo shoots for your clients.

How then can one distinguish between needs and wants? An objective examination of the degree of necessity and different situations can help justify why the same things can be wants or needs for different people.



Activity

Examine the pictures shown below. In the table provided, write three items which you consider to be needs and three which you consider to be wants. Justify your choices. The first one has been done for you.



Source: www.vecteezy.com

Needs	Justification	Wants	Justification
1. Food	Nutrients from food are needed for people to survive.	1. Car	A car is a desire rather than a need, because people can survive without one.
2.		2.	
3.		3.	

Figure 1

Now that you have completed this activity, reflect on your answers and compare them with the solutions provided below:

Needs	Justification	Wants	Justification
1. Food	Nutrients from food are needed for people to survive.	1. Car	A car is a desire rather than a need, because people can survive without one.
2. Shelter	People need a place to live in order to stay safe and well.	2. Jewelry	It is nice to have beautiful items, but they are not essential.
3. Clothing	People need clothing to protect them from elements and the environment.	3. Cell phone	Although very convenient, they are also not necessary for survival.

The difference between needs and wants should be clearer to you. Needs are items necessary for survival and wants are items desired but which are not necessary for survival.

Items needed and wanted by people can be classified into goods and services.



Reflection

Goods and services

Consider the following example:

You go to the hairdresser or barber for a haircut and while there, you buy a bottle of shampoo.

Is the haircut a good or a service? Why?

You are correct if you said the haircut is a service. It is an intangible act performed for you.

Is the bottle of shampoo a good or service? Give a reason for your answer.

The bottle of shampoo is a good because it is tangible or something physical you will have.

Did this good and service satisfy your need or want?

Now put this information together and write a definition of goods and services using the lines provided below:

Check your answer with the following definitions:

Goods are tangible or physical items that have the power to satisfy needs and wants. They are items that you can feel, touch, own and use, for example, cars, food, books and clothes.

Services are intangible acts that are performed to enable satisfaction of needs or wants. For example, a taxi driver performs the service of transport, a waiter performs the service of serving you in a restaurant and a music band entertains you with music.

What makes it possible for us to get these goods and services that we need and want? In most cases, we buy them because of decisions by businesses and government to engage in economic activity to produce and offer them for sale. Do you think it has always been like this? Let us take a brief journey back to the early days of civilisation to see how people produced what they needed.

Economic Activity in the Early Days of Civilization

How do you think people who lived thousands of years ago satisfied their

needs? Do you imagine it would have been the same way you do today? Let us take a brief look at their life.

In the early days of civilisation, people lived very simple, nomadic lives with only the basic need for food. They moved from place to place, hunting animals and gathering berries and fruits to get just enough food to survive. As time passed, they began to settle down in families and start communities. They built homes using trees, stones and other items from nature. They cultivated plants they found to be edible, reared animals they caught and made clothing from the skins of animals. This was the beginning of production, an essential component of economic activity.

The picture below is an illustration of what a typical community of persons in the early days of civilisation may have looked like. As you are aware, cameras were not invented then so we have to rely on illustrations.

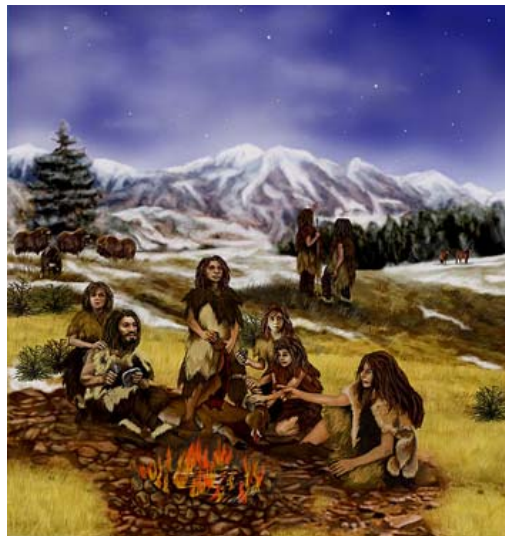


Figure 2: Community of persons in the early days of civilisation

Source: http://upload.wikimedia.org/wikipedia/commons/3/33/Neanderthals_-_Artist%27s_rendition_of_Earth_approximately_60%2C000_years_ago.jpg

In this illustration, you get an idea of the type of dwellings people lived in, the kind of clothes they made to wear and how food was prepared. People used what was available in the natural environment and produced just enough to satisfy their basic needs for food, clothing and shelter. They engaged in direct production because they made everything they needed for themselves and their families. The way this community organised its economic activities is known as a subsistence economy.

As time progressed, they developed simple tools that helped make their tasks easier and yield more items. Some people became more skilled at certain activities and concentrated on those. They became specialists in their respective areas. View the cartoon below:



Figure 3: Gatherer and Hunter

Source: http://upload.wikimedia.org/wikipedia/commons/c/cc/Kalina_hunter_gatherer.jpg



Reflection

Imagine you were a skillful hunter in the early days. What benefits would you be able to enjoy from specialising in this activity?

Let us see if you thought of the following:

Specialising in the activity you are skilled at will enable you to work faster and better. You will be able to get more animals and this might be a lot more than you and your family need. However, you will have this surplus of meat but none of the other things you were unable to produce.

What would you have done to solve this problem?

People soon realised that they could exchange their surplus items with other people who had surpluses of different items. This was the beginning of an exchange system called barter.

What is Barter?

Barter is the direct exchange of goods or services for goods or services. This economic activity of exchange enabled people in the early days to enjoy the following benefits:

1. Use surplus goods to exchange for goods they did not have.
2. Enjoy a wide variety of goods without having to produce them all.



Activity

Imagine you were a hunter with extra deer you wanted to exchange to get corn. The friend you usually barter with has corn but wants peas, not deer. Another person has peas but wants a deer.

Write the answers to the following questions:

1. What will you have to do to get peas for a successful exchange?
2. What are some of the problems you may face?
3. What will be your greatest benefit if the exchange is successful?

You are on the right path if you wrote:

- ✓ For a successful exchange, you will first have to trade the deer for the peas. Then exchange the peas for corn.
- ✓ Some problems you may face are:
 - How many peas should you get to be equal to the value of the deer?
 - If the deer dies or the peas and corn decay, the exchange will not be successful.
 - It might be inconvenient to carry around the deer.
- ✓ However, you will benefit by getting rid of surplus goods to get something you want.

From this scenario, you will realise that barter provided important benefits but unfortunately there were some problems with the exchange process.

Problems encountered with barter

1. **Difficulty in determining a rate of exchange:** Goods were of different values in terms of size, durability and usefulness. There was no system for determining how much of one good should be given in exchange for goods of different values.

2. **Indivisibility:** Some goods could not be divided, or they would lose their value if they were divided to exchange for goods of lesser value.
3. **Inconvenience:** It was difficult for a person to always find someone who had what he wanted and who wanted what he had.
4. **Perishability:** Animals and crops used for bartering could die or spoil and thus be worthless. This made saving for the future difficult.

The benefits of barter were so important that people kept trying to find a more convenient way to facilitate exchange. Many different strategies were used by different people in different countries. Non-perishable items, such as beads and precious metals, were tried but there were still problems. A money system of notes and coins eventually developed independently in different countries. The actual form of money varies among countries but its functions are common universally. It is these functions that are used to define money and explain its importance in economic activity.

Functions of Money

Money has many important functions.

1. **A medium of exchange:** Money can be exchanged for all goods and services that are offered for sale. It is universally acceptable as a legal form of payment.
2. **A measure of value:** All goods and services have a price in terms of money to indicate their value. Money is divisible to enable exchange for goods of any value.
3. **A store of value:** Money is durable as the material it is made from will not decay. It can be saved to spend in the future or be invested to increase wealth.
4. **A standard for deferred payment:** Money allows credit transactions where people “buy now and pay later”. Prices of goods and services can be divided into smaller, affordable amounts of money, to be paid by the buyer over a period of time.

We will now take a leap into the 21st century to examine our contemporary economic activities. Centuries have passed and major inventions and developments have revolutionised how economic activities are done and the way people now live.

Economic Activity in our Modern Day Economy

Our present modern day economy is powered by money. Money impacts all aspects of economic activity.

Money and production

Money is both an incentive for and a facilitator of production. Producers are encouraged to undertake the economic activity of production because they will receive money when consumers buy what is produced. What people are willing to buy will indicate to producers what and how many goods and services to produce.

In making production decisions, money also plays a key role. Money is the basis producers use to estimate the cost of acquiring resources, labor and tools for production. A selling price is then calculated to cover costs, plus the money or profits the producer desires for the undertaking.

The ability to earn and borrow money enables producers to embark on production of varying natures and sizes. In our present economy, businesses produce a vast array of goods and services, aimed at satisfying any needs or wants that a person might have. Industrial, agricultural, financial and commercial businesses exist and range in size, from giant multi-national corporations to local large, medium and small scale operations. You will learn more about these in subsequent units.

Money and consumption

Today money can be used to pay for virtually anything. Almost all goods and services are priced in terms of money, which facilitates the exchange process. People also have additional freedom to buy even if they do not have sufficient cash. They can do so through loans and a credit system. Apart from notes and coins, the money system now includes other instruments that facilitate payments. Some examples of instruments of exchange used in our present day economy include cheques and electronic money transfers, which include the use of credit and debit cards. You will learn more about this in Unit 16.

Some instruments of exchange are shown below.



Figure 4: Currency notes and coins



Figure 5: Credit and debit cards



Figure 6: Machine for electronic money transfers

Source: http://upload.wikimedia.org/wikipedia/commons/3/3a/Credit_card_swiping_machine.jpg

Even though these instruments of exchange are now widely used, a modern day version of barter exists today. Some people may barter services, for example, a teacher may give extra lessons to the gardener's child in return for the gardener mowing the teacher's lawn.

Technological developments now enable local and international exchanges without the use of money. This is done by networking with others on the internet. A little surfing of the internet will reveal a host of special sites for bartering, such as Barter Palace and Barter Quest. The idea is the same as barter in the early days but now items have monetary values to ensure a fair exchange.

Money and distribution

Our present day production results in a wide variety of goods and services which are made possible by the use of resources or factors of production. These are broadly classified as land or natural resources, human resources (the people who do the work), and capital or man-made resources, such as machines. You will learn more about this in Unit 4.

Unlike the early days of civilisation, to use resources they must be bought from the people who own them.

Distribution as an economic activity refers to how the value of output produced is shared among the factors of production. The contribution of each factor to production is measured in terms of money and that amount is paid to the owners. Thus, from the total money earned from sale of what is produced, payments are distributed among the owners of the different factors; for example, the persons who provide labour will receive wages or salaries. It is important to understand that money facilitates distribution, as it is the reward paid to all factors engaged in the economic activity of production.



Activity

On the lines below, describe three ways in which money is used in modern day economic activities:

If you wrote that money pays for goods, for services, and that it serves as a medium of exchange in business, you are on the right track!

You will now turn your attention to other aspects of economic activity.

Indirect production, division of labour and specialization



Reflection

Think about all the goods and services you and your family use. Do you make them yourselves? Most likely you will answer “no”.

Today, many people are involved in producing a wide range of goods and services to satisfy our needs and wants. This is known as indirect production. The two major features of this type of economic activity are the practices of division of labour and specialisation.

To divide means to break up something into different parts. This is the basic idea of division of labour. The task of production is separated into different activities and persons with the relevant skills perform each one. Specialisation, as you will recall, means doing what one is most skilled at.



Activity

Consider the production of a car in Japan. Try to identify the different production tasks and persons that are required before a car made in Japan can be offered for sale in your country.

Firstly, there will be the designer to draw the design for that particular model. The tyres, engine, battery, glass and other components will be made by different people, sometimes in separate firms in different parts of the world. Other people will assemble these components to create the completed car; the car will then have to be transported to the car sales outlet in your country.

From this simplistic illustration, you can see how different modern day economic activities are from the early days. Unlike the early days of civilisation, indirect production is a big part of today's economic activity. Indirect production is evident when different people play a small part in producing a specific good or service, as we just saw in our example of car production in Japan. Thanks to people's indirect production, we can satisfy our needs and wants.

Division of labour is practiced when the whole production process is divided into different tasks, which are performed independently and then brought together to get the final good or service.

Specialisation is now practiced at the following levels:

- Individuals: Many persons undertake training to acquire specific skills and become specialists in a particular area, such as engineers, chefs, lawyers and mechanics. You can also think about other examples of specialists.
- Industries: Most businesses today specialise in specific areas of production and make specific goods or services. For example, in manufacturing, businesses specialise in making different types of processed food, electronics, vehicles, cosmetics or books.
- Countries: Some countries have resources which have made them proficient in the production of certain goods and services. For example, Japan specialises in the production of cars and electronics; Jamaica in the production of coffee; New Zealand in the production of dairy products. What does your country specialise in?

Large Scale Economic Activities

Almost all countries today have highly specialised, large scale industrial, agricultural, financial, and commercial economic activities. The pictures below provide a glimpse of some of these.

Modern day industrial activity



Figure 7: An industrial area at Pt. Lisas, Trinidad

Source: <http://www.flickr.com/photos/knowprose/2112767021/sizes/m/in/photostream/>

The industrial area in the picture above shows industries which produce goods such as methanol, liquified natural gas, ammonia, urea, fertilizers, iron and steel. People in the early days of civilisation were not even aware of these goods.

Modern day agriculture



Figure 8: Modern day agriculture

Source: http://s0.geograph.org.uk/geophotos/02/07/19/2071969_7590cebd.jpg

Agricultural production often has huge areas of land under cultivation, using machinery to facilitate large scale production of crops and rearing of animals. Production is able to meet local needs and sometimes also yield surplus for export to other countries.

Modern day financial activity



Figure 9: Modern day bank (Bank of America)

Source:

http://upload.wikimedia.org/wikipedia/commons/thumb/2/26/Bank_of_America_Building%2C_Midland%2C_Texas.jpg/450px-Bank_of_America_Building%2C_Midland%2C_Texas.jpg

Financial institutions like banks now offer financial services, such as accepting deposits, lending, and facilitating local and international payments or money transfers.

Modern day commercial activity



Figure 10: Shopping for food items in a supermarket

Source: <http://upload.wikimedia.org/wikipedia/commons/thumb/8/8b/Instant-noodle-isle-2007.jpg/120px-Instant-noodle-isle-2007.jpg>

Commercial businesses of all sizes are predominant in the cities and towns of most countries. There is virtually no limit to the range of goods people can now buy at commercial businesses, such as in the large supermarket shown in the above picture.

The above pictures show very large business operations, which again show you how modern day economic activities differ from the early days of civilisation. Please note that these pictures are not intended to suggest that all modern day economic activities are of the type shown. As stated earlier, economic activities range in size from subsistence production in some areas to small, medium and large scale operations in other areas; furthermore, the existence of these vary from country to country.



Activity

You will now begin preparation of a scrapbook. Your scrapbook you will feature different types of economic activities that are carried out in your country.

Collect at least ten pictures of businesses from newspapers or, if possible, take some photos yourself. Try to gather pictures showing a wide range of economic activities of different businesses. Place these pictures in your scrapbook.

For each picture you should write a few lines indicating what economic activity the business is engaged in. As you proceed with this course, this scrapbook will be useful when you need to give local examples of businesses.

Technology and economic activity

In our present time, economic activities have been greatly enhanced by improvements in technology and transportation. This has changed the way business is done. Inventions of machines and new discoveries have increased the quantity and quality of products that can be produced. At the touch of a button, business transactions can be conducted with most places worldwide. Transportation makes the delivery of any good or service to any place possible. You will learn more about this in Unit 9.

The Basic Economic Problem of Scarcity

The needs and wants of modern day human beings are greater and more varied than those of people in the early days of civilisation. Surrounded by all types of attractive and enticing goods, the more people get, the more they tend to want. As one want is satisfied, it is replaced by another. This means that **man's wants are unlimited**.

However, available resources are not enough to produce all the goods and services required to satisfy all the wants of human beings. This means that **resources are limited**.

Unlimited wants versus scarce resources result in the economic problem of scarcity.

Scarcity means that there is not enough of something to meet a particular requirement. It is caused by the fact that our limited resources are insufficient to meet the unlimited wants of all persons.

Scarcity occurs at all levels: the individual, the business and the country. Economic activities now have to address the problem of scarcity.



Reflection

Do you have enough money to buy **everything** you want?

Like most of the general population, you probably do not. So we are all experiencing the economic problem of scarcity because of our limited resources.

Suppose you have \$1000 to spend and you want both a cell phone and a pair of brand name sneakers. Each item costs \$1000. What will you do since you cannot afford to buy both?

Will you make a choice? Will you buy the item that will give you the most satisfaction or benefit?

When you make a choice, you sometimes have to give up your other wants or options. The want or option that is given up is called opportunity cost.

Opportunity cost refers to the option or alternative that is given up or foregone when a choice is made.

With your limited money you can buy:

Sneakers

or

Cell Phone



Source:

http://farm3.static.flickr.com/2712/4360642567_572b3a744d.jpg

Source

http://farm4.static.flickr.com/3268/3151902438_04af75d750.jpg

Figure 11

If you choose the sneakers then the cell phone is the opportunity cost. If you choose the cell phone then the sneakers is the opportunity cost. The actual choice you make will depend on which option gives you the most satisfaction or benefit.

Businesses sometimes also experience the problem of scarcity as they may not have sufficient resources to produce all the goods and services that people want. Businesses usually choose to allocate their relatively scarce resources to produce what will give them maximum profits and best meet the wants of consumers.

Let us now apply the concept of opportunity cost to countries.



Discussion

Consider the following scenario:

An empty lot of land in your country can be used to build either a sports complex or houses for low income persons. What is the opportunity cost involved in this decision? What do you think should guide the choice on how the land is used? Discuss this with your classmates/tutor.

The Choices

Low income housing



Source:
http://farm3.static.flickr.com/2712/4360642567_572b3a744d.jpg

Sports complex



Source:
http://upload.wikimedia.org/wikipedia/commons/5/51/Jeju_World_Cup_Stadium.JPG

Figure 12

From your discussion, you will realise that:

The sports complex will benefit persons participating in sporting activities but the opportunity cost of this choice will be not building houses for low income persons.

Conversely, building the houses will provide homes for low income persons but there will be no venue to engage in sporting activities.

Which one is needed more? Which project will give the greater benefit to more people? Answers to these questions will influence the choice made. The limited resources of countries have alternative uses. When a choice is made to use resources for a particular purpose, the opportunity cost will be the other uses and benefits that have to be given up or foregone.

In reality there is no simple solution to the economic problem of scarcity because resources are always limited relative to the unlimited wants of people. As countries attempt to tackle this economic problem of scarcity, they need to find answers to three resource allocation questions.

The three resource allocation questions are:

1. What goods and services should be produced?
2. How should goods and services be produced?
3. For whom should goods and services be produced?

How a country chooses to answer these questions determines the nature of its economic activities and its economic system. This will be explored in the next three sessions of this unit.

Before that, let us review the main points covered in this session.

Session Summary



Summary

In this unit you learned:

- Needs are items necessary for survival of people and wants are items desired but which are not necessary for survival.
- Goods are tangible or physical items that have the power to satisfy needs and wants, while services are intangible acts that are performed to enable satisfaction of needs or wants.
- In the early days of civilisation there was direct production in a subsistence economy where persons acquired just enough to meet basic needs and survive.
- Eventually people practised specialisation, which resulted in surplus or extra goods being made.
- Barter developed to exchange surplus goods for other goods. People were able to enjoy a wider variety of goods.
- Problems with barter included the perishable nature of goods, indivisibility, and difficulties in determining a rate of exchange and finding a mutual exchange.
- After using many items to try and solve the problems of barter, the money or currency system of notes and coins was developed.
- Money is durable, divisible, portable and generally accepted in exchange for all goods and services in our modern day economy.
- Money serves as a medium of exchange, a measure of value, a store of value and a standard for deferred payments.
- Modern day economic activity incorporates a wide variety of businesses producing and distributing almost every imaginable good or service that people are willing to buy.
- Man has unlimited wants but resources to produce goods and services are limited; this causes the basic economic problem of scarcity.
- Scarcity requires that a choice is made. When a choice is made, the benefit or option given up is called opportunity cost. The choice made should result in a greater benefit than cost.
- All countries have to choose how to allocate their scarce resources to solve the economic problem of scarcity; this is done by finding answers to the three questions of what, how and for whom to produce.

Assessment



Assessment

Answer all of the questions below. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. a. Discuss two problems of barter. (2 Marks)

b. Explain how money would help to solve the two problems of barter you identified above. (2 Marks)

2. a. Explain why the economic problem of scarcity exists. (2 Marks)

b. Use an example to illustrate the concept of opportunity costs. (1 Mark)

c. Identify the three questions that all countries have to address to deal with the economic problem of scarcity. (3 Marks)

Total: 10 Marks

Session 2: The Free Enterprise Economic System

Introduction

All countries of the world have a way in which they organise their production, distribution and consumption to solve the economic problem of scarcity. In the last session, you learnt that this problem exists because of limited resources and unlimited wants. To solve this problem, a choice has to be made on what, how and for whom to produce goods and services. The answers to these questions will determine how resources are allocated in the production, distribution and consumption of goods and services. This will influence the type of economic system that will develop in a country.

In this session, you will examine what an economic system is, and identify the three major economic systems. You will also describe the characteristics, advantages and disadvantages of one of them, namely the free enterprise economic system. We will explore the other two in the follow-up sessions.

Upon completion of this session you will be able to:



Outcomes

Explain what an economic system is.

Identify the three major economic systems.

Define the free enterprise economic system.

Describe the characteristics of the free enterprise economic system.

Discuss the advantages and disadvantages of the free enterprise economic system.



Terminology

Merit Goods:	Goods and services that give more benefit to the society than to the individuals who use them.
Government:	The body with the authority or power to administer over a country/state.
Consumer sovereignty	The power of the demand of consumers to determine how resources are allocated to production.
Transaction:	The exchange of a good, service, or information for payment between a buyer and a seller.

Market:	An interaction between buyers and sellers to transact business.
Private investors:	An individual who puts finance in a business with the hope of making a profit.
Infrastructure:	Services or facilities provided on a large scale for use by members of the public, e.g., roads, schools, transport and communication networks.



Reflection

What do you think a system is?

When a student was asked this question, he said a system is “a group of people or parts working together”. Do you agree? Look at this answer again. A group of people working together is considered to be a team. This is partially correct as the people or parts may be only one element of a system. A system is a set of procedures for achieving something.

Let us use the example of the education system.

What do you think it wants to achieve?

Your answer may be to produce educated citizens.

How is this outcome achieved?

Mechanisms are put in place to expose students to various learning experiences. These learning experiences should develop knowledge, skills and attributes necessary for students to become productive, educated citizens.

A system is thus made up of three elements:

1. Input: the act of putting in (Collins Dictionary).
2. Throughput: the process which acts on the input to bring about desired changes.
3. Output: the end results or modified change as a result of the process the input undergoes.

The stages in the education system are illustrated in the diagram below:

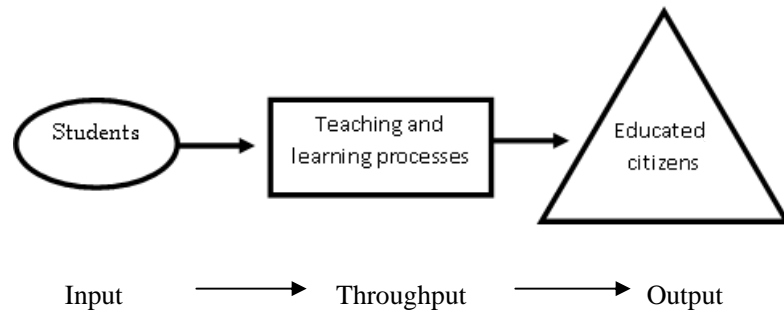


Figure 13: Illustration of the Education System

In our example of the education system, the input will be students that enter the system at the pre-school, primary, secondary or tertiary stages. The throughput will be the teaching and learning experiences which act on the input (students) to bring about desired changes. The output is the end result which will be productive, educated citizens.



Reflection

You will now apply this concept of a system to an economy.

What output does an economic system want to achieve?

If your answer is goods and services for consumption, then you are correct.

What input is needed to achieve this desired goal?

Did you think about land, people and tools? You are correct because these are the resources necessary for production and distribution of goods and services.

What is needed to transform these resources into goods and services? You should be thinking about the production process.

The stages in an economic system are shown below:

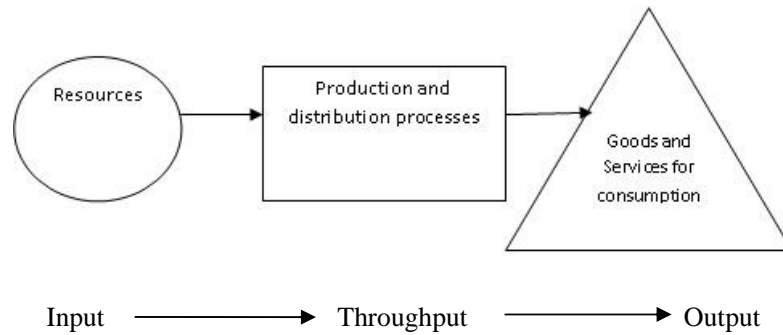


Figure 14

In the illustration of the economic system above, the inputs are resources, the throughput is the production process and the output is the goods and services made to satisfy needs and wants.

An economic system is the way in which a country organises its resources to produce and distribute goods and services for consumption. Recall from Session 1 that resources available to produce goods and services are limited while needs and wants of people are unlimited. This results in the economic problem of scarcity. How countries organise their resources to solve this problem will determine the type of economic system.

You will now examine the various types of economic systems.

Types of Economic Systems

In an attempt to solve the economic problem of scarcity, countries will choose the most appropriate means to utilise their scarce resources. To do this, countries need to address the following three basic resource allocation questions:

1. What goods and services should be produced?
2. How should goods and services be produced?
3. For whom should goods and services be produced?

To answer these questions, three dominant types of economic systems have emerged:

1. **Free enterprise economic system:** This is an economy in which resources are owned and controlled by private individuals and businesses.
2. **Planned economic system:** This is an economy in which resources are owned and controlled by the government or state.
3. **Mixed economic system:** This is an economy in which resources are owned and controlled by both private individuals and businesses and the government.

The types of economic systems can be shown on a continuum.

A continuum is a line showing the gradual change from one condition to a different condition. In a continuum, extremes of conditions are depicted on either ends of the line. All points between the two extremes show different degrees of mixtures. A continuous movement along the line would lead to the opposite position at the other end. The middle, therefore, would be a balanced mixture of both extremes.

The diagram below shows the continuum of the economic system

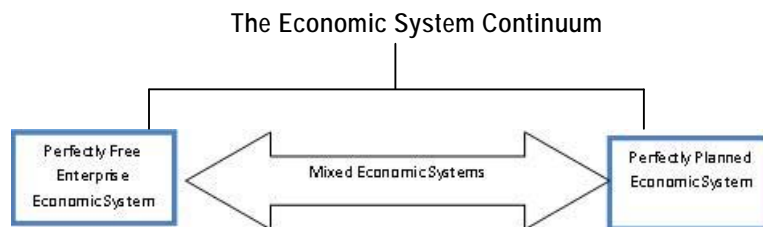


Figure 15

In Figure 15 above, the perfectly free enterprise and perfectly planned economic systems are on the two extremes of the continuum. These depict the ideal perfectly free enterprise and planned economic systems. In reality these do not exist. Any point between these two extremes will represent varying degrees of mixed economic systems.

Now you can examine the free enterprise economic system.

Free Enterprise Economic System

The word “free” means voluntary. If you are “free”, what you do is a matter of your choice and your actions are not controlled by anyone. “Enterprise” is a business undertaking or venture, for example, the making of sweets by “Tanty Merle” for sale. An economic system, you will recall, is the way in which a country organises its resources to produce and distribute goods and services for consumption.



Activity

Now combine the above explanations to get a definition of the free enterprise economic system. Share your answer with your classmates/tutor.

Check your definition with the following one:

The free enterprise economic system is the voluntary undertaking of private individuals and businesses to undertake ventures to produce goods and services to satisfy the needs and wants of consumers.

Other terms used to describe the free enterprise economy are market economy, capitalist economy or laissez faire economy.

In Figure 16 below, the input in the free enterprise economic system is the resources owned by private businesses.

The throughput refers to the processes that the input undergoes in the production of goods and services.

The output is the goods and services that are produced to meet the wants of consumers.

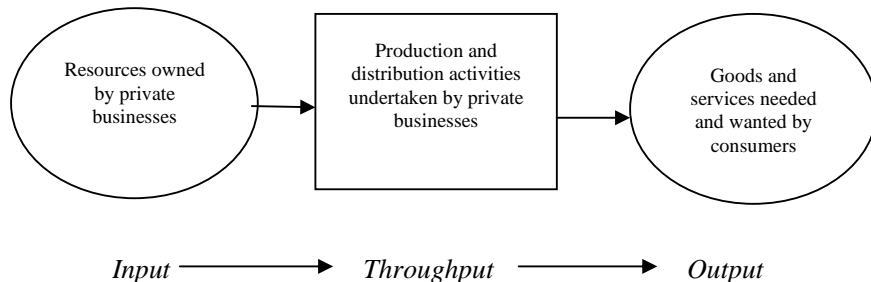


Figure 16: Illustration of the Free Enterprise Economic System

Characteristics of the Free Enterprise Economic System

1. **Ownership of resources and businesses:** Private individuals and businesses own resources. They have exclusive rights to organise resources to decide what, how and for whom to produce. They are also free to enter into business ventures. Some examples of businesses owned and controlled by private persons include:

Food



Source:
http://farm1.static.flickr.com/37/75797080_7ca0eeabea_o.jpg

Clothing



Source:
http://farm3.static.flickr.com/2741/4444576795_108f15ae9e.jpg



Housing

Source:
http://farm1.static.flickr.com/165/349057306_1b8709e297.jpg?v=0



Transport

Source:
http://farm2.static.flickr.com/1176/547474053_768d8c64d2.jpg

Figure 17

The motive for entering into business is to make a profit.
You will now examine this motive.

2. **Motive for production:** In the free enterprise economic system, the motive for production is to make profit. Individuals use their wealth to fund businesses in the hope that they will make profit.

What is profit? Profit refers to excess revenue a business earns from selling its goods and services after it has covered the costs of producing them.

Profit is calculated using this formula:

Profit = Total revenue – Total costs of production.

Total revenue is money made from selling the goods and services. It is found using this formula:

Total revenue = Quantity sold x Price.

Total cost is money spent to produce goods and services.



Activity

Examine the following example to calculate profit:

It costs a business \$100,000 to make ten thousand cricket bats.

The bats are sold at \$150 each.

What will be the total revenue from sales?

Did you get \$150,000? Very good.

How did you arrive at that answer?

Did you multiply quantity (100 000 bats) by price (\$150). That's great!

What will you get if you minus total cost from total revenue?

Did you get \$50,000? That's correct.

This excess revenue after costs are covered is called profit.

Once profit is made, people are motivated to get into and stay in business. If profit is not made, people will be forced out of business.

Consumers are free to use their limited income to buy goods and services. Consumers will select the best combination of goods and services from which they are able to get total satisfaction or utility. Utility means that the user derives satisfaction from using the goods and services. If consumers are willing and able to pay for the goods and services they desire, then the businesses, in their capacity as producers, will use their wealth to enter into these business ventures.

Private individuals and businesses decide on what, how and for whom to produce by studying consumers. They use their resources (physical and human) to produce the goods and services that consumers want.

In doing so, businesses will be able to obtain the highest profit possible. This is referred to in economics as profit maximization.

The profit motive, that is, the motivation that businesses have to make profit, drives investment and production.

Private businesses are always looking for new opportunities to make profits.



Reflection

Think of some new products that businesses have introduced in recent years.

Did you think of businesses such as internet or cyber cafes, cruises, health spas and gyms? You will notice that private businesses such as these have become popular because people are willing to pay for these services. Also, these types of businesses have a high potential for profit and continuity for business owners.

3. **Role of government:** In the free enterprise economic system, there is little or no government interference in private business activity.

The role of government is restricted to making and enforcing laws to protect the environment and to safeguard consumers and workers from unfair business practices.

In addition, the government may undertake production of goods and services that are not profitable for private individuals and businesses to undertake, such as education and health care services.

Another role of the government is to provide the infrastructure needed in the country, such as roads, bridges, a communication system and provision of power supply.

A special role of government in developing and under developed countries is to encourage foreign investors to set up businesses locally.

The government, therefore, is a mere facilitator of business operations and only gets involved in activities that are not profitable to private businesses.

Some examples of government involvement in the free enterprise economic system are shown in the pictures below.



Hospital

Source:
<http://upload.wikimedia.org/wikipedia/commons/8/87/Geelong-hospital.jpg>



School

Source:
http://upload.wikimedia.org/wikipedia/commons/3/30/Benin_classroom.jpg



Power Supply

Source: http://upload.wikimedia.org/wikipedia/commons/9/95/Statfjord_A.JPG

Figure 18

4. **Production and distribution of goods and services:** The private sector has a major role in the production and distribution of goods and services. The goods and services are produced and distributed through the market system. In the market, the prices of goods and services are determined by the price mechanism. In other words, the price depends on the amount demanded by consumers and the amount supplied by producers. This concept of price mechanism will be explained in Unit 12.

In the free enterprise economic system, buyers and sellers make business transactions daily. It is these transactions that determine what goods and services to produce. This occurs because producers or sellers will supply or offer for sale what buyers want to buy. Thus, the consumers demand for goods and services will influence what is produced and the quantities produced. Production is thus said to be market driven. Scarce resources will be allocated to produce the goods and services consumers want.

Consumers thus have “consumer sovereignty”, meaning that consumers have the power to determine what is produced. The consumer is “king” because what he/she is willing and able to buy greatly influences how producers will allocate scarce resources. Producers, knowing that a profit can be obtained, will supply the goods and services from which they can make the greatest profit. In other words, they would produce goods and services from which they can achieve “profit maximization”.

In order to achieve profit maximization, producers try to minimize the cost of producing the goods and services. Cost minimization is the act of keeping the input in the production process at the lowest possible level, so as to gain the highest level of profit. . Producers will try to obtain quality raw material at the lowest price, curtail the price of labour and use the technology that will enable them to produce the goods or services at the lowest cost.

The cost of production will influence how much is supplied and the prices at which suppliers will offer goods and services for sale. Prices, in turn, will determine how much is demanded and also for whom the goods and services are produced. In other words, goods and services

will be produced for those willing and able to pay for them. One's income is a major determinant of what goods and services one can access.

Some examples of the productive activities in which businesses may be involved are shown below.



Office Worker

Source:
http://upload.wikimedia.org/wikipedia/commons/8/85/Office_Worker_with_Two_Monitors.JPG

Forklift Operator

Source:
<http://upload.wikimedia.org/wikipedia/commons/9/90/Forklift.JPG>

Figure 19



Reflection

Do you think that if teenagers stop purchasing sneakers at \$1,200.00 the sellers will continue to import these sneakers?

Who really determines what is produced and how resources are used in the economy?

Your answer to the first question should be no, because there is no demand for that good.

For the second question, you will realise that it is buyers who determine what is produced and this in turn affects how resources are used.

Explain how the free enterprise economic system attempts to answer the three basic economic questions of:

1. What goods and services should be produced?
2. How should goods and services be produced?
3. For whom should goods and services be produced?

Refer to the Learners Guide for the answers to these questions.

Now that we've discussed the characteristics of the free enterprise economic system, let us examine its advantages and disadvantages.

Advantages of Free Enterprise Economic System

Now that you have learnt the characteristics of a free enterprise economic system, think about the advantages of this system.

If you thought that one of the advantages of a free enterprise economic system is that consumers have greater variety from which to choose, then you are correct. In economics this is referred to as consumer sovereignty (power).

Read about this advantage below:

1. Consumer sovereignty (power) and choice

In this type of economic system, the consumer is “king”. This means that the consumer has unrestricted purchasing power. It is the power of consumers that decides what gets produced. For example, if consumers exercise their purchasing power by buying more bananas than apples, the banana producers will make more profit and, therefore, may increase the production of bananas and decrease the production of apples. Consumers have thus determined what is produced.

Consumers' choice thus influences what goods and services are produced in a free enterprise economic system. This is because consumers determine how scarce resources are allocated to productive activity.

Consumers exercising their purchasing power in a vegetable market



Source: Photography by Christopher Steele (T&T)

Figure 20

Now think about another advantage of the free enterprise economic system.

If consumption determines what to produce, then resources are allocated to the production of goods and services that consumers need and want. What is an advantage of this situation?

If you are thinking that there will be a higher level of efficiency, you are correct. Now examine this concept.

2. Higher level of efficiency

In the free enterprise economic system, there is likely to be a high level of competition since there are many firms operating in the economy. This results in greater efficiency in the use of resources. In other words, firms make good use of the resources available. There is little or no wastage in the production process.

Now examine this scenario.

You and your friend each decided to make and sell cupcakes. Both of you used the same quantity of ingredients and the same size of baking tins. You got 12 cupcakes from your effort while your friend got 10 cupcakes. With the same input, you were able to achieve greater output. So the question arises: why the difference in the level of output? One possible answer is that you may have been operating at a higher level of efficiency and this efficiency may have been as a result of less wastage or spillage.

Similarly, firms may use the same quantity of input but the output amount or level may be different. The firm in which the output is larger may be operating at a higher level of efficiency. As noted above, one way in which this is achieved is by controlling the levels of wastage.

Greater efficiency may also be achieved through the use of machines in

the production process or by having more skilled workers in the workforce. These factors may allow such firms to produce their goods and services at a lower cost.



Note it!

Greater output and lower production costs are two indicators of higher levels of efficiency.

Think about another advantage of the free enterprise economic system. Examine the fact that private businesses and individuals are free to invest in any product of their choice. What about the level of competition? Would this encourage innovation?

If you think that freedom to invest would encourage production of more goods and services and that competition among producers would encourage innovation and new designs, then you are correct. The advantage is that there would be increase in businesses and because of this increase the investors would try to “out do” each other by making their products different. You may now examine this in greater detail.

3. Increase in investment and innovation

In this market economy, firms are continuously trying to improve their products to “out do” their competitors. Very often firms come up with new ideas. This may require increased investment in order to bring new products to the market or to place the products on new markets. One example of the latter is online sites, such as eBay.

eBay functions like a commodity market, in which a wide range of goods are bought and sold by a wide range of buyers and sellers respectively. The internet has made this new type of market, one that represents an innovative way for buying and selling, possible..

Some items which can be purchased on eBay are seen below:



Jerseys

Source:
http://farm3.static.flickr.com/2267/2294317099_1bf98e4f62.jpg



Cell Phone

Source:
http://farm4.static.flickr.com/3268/3151902438_04af75d750.jpg



Tractor

Source:
<http://upload.wikimedia.org/wikipedia/commons/7/7d/For-d-Tractor.jpg>



Rims

Source:
http://farm3.static.flickr.com/2353/2142217010_cae979f945.jpg

Jet

Source:
http://upload.wikimedia.org/wikipedia/commons/thumb/4/44/Jet_provost_t5_fairford arp.jpg/800px-Jet_provost_t5_fairford arp.jpg

Land in Arizona

Source:
http://s0.geograph.org.uk/photos/81/07/810764_9a13258d.jpg

Figure 21

You can examine the characteristic of the profit motive to explore another advantage of the free enterprise economic system.

4. Profit Motive

In this type of economic system, firms are driven to maximize profits. The incentive to produce is the high profit received and, thus, the profit motive is a factor in determining what, how and for whom goods and services are produced.

You can use the acronym '**CHIP**' to assist you in recalling the advantages of a free enterprise economic system. These are listed below:

- **C**onsumer sovereignty (power) and choice
- **H**igher efficiency
- **I**ncrease in investment and innovation
- **P**rofit motive

Having examined the advantages of the free enterprise economic system, you can now turn your attention to the disadvantages.

Disadvantages of the Free Enterprise Economic System

You may recall that one of the characteristics of a free enterprise economic system is that private individuals and businesses are free to invest. The government has little or no role in this type of economy. What is the disadvantage of government not having any role?

If you think that there will be no regulations in the economy except for those imposed by private individuals and businesses, then you are correct. You can read about the failure to self-regulate the economy in the section below:

1. Failure of businesses to self-regulate

There are instances when a free enterprise economic system may fail to regulate itself. Regulating itself means that within the market there are checks and balances to correct problems that may arise. Problems, such as not adhering to proper investment practices, may cause the collapse of the financial sector if allowed to go unchecked for a long period of time. Self-regulation is important in business so that unethical individuals can be held in check. Failure to control individual behaviour may bring the business into disrepute and thus may cause the consumer to lose faith in the business sector. The lack of confidence in the business sector could lead to a slowdown or a recession in the economy. When this happens, the government may be forced to intervene to rescue businesses from failure. This occurred in the United States in 2008 with the collapse of various financial institutions. This failure plunged the economy into economic recession.

In addition, if companies are allowed to go unchecked, they may develop into monopolies. Monopolies are large businesses which seek to raise the prices of their goods by restricting output. This practice is unfair to consumers. Monopolies will be discussed in Unit 12.



Note it!

Self-regulation is critical to the survival of the business sector.

Think what might happen if there were no self-regulation in the economy. Do you think that individuals and businesses would act fairly? Before answering this question, complete the activity below.



Activity

Have you ever engaged in unfair trading practices? If yes, what did you do?

Your answers may be that:

- ✓ you sold an item to your friend for a price higher than you should have.
- ✓ you purchased copies of CDs and DVDs on the streets because they were much cheaper than the original.
- ✓ you copied your friend's homework and passed it off as your own.

If you have engaged in any of those practices, then you may have engaged in unfair practices. Similarly, businesses may engage in unfair trading practices. You will now explore this further.

2. Unfair trading practices

Unfair trading practices include unfair pricing, false claims in advertisements, infringements of copyright and patent, trade names and trademarks. Further explanation on copyright and patent will be dealt with in Unit 14.

In order to ensure that their goods and services are identifiable and distinguishable for high quality, businesses spend tremendous amounts of money on branding themselves. Because of the competitive nature of the free enterprise economic system, some firms may engage in falsely copying or designing emblems or symbols that closely resemble those of reputable firms. In addition, competition does not always bring about high efficiency because firms may have formed cartels or monopolies and thus be able to manipulate market conditions in their favour. This clearly shows that there is a need for governments to intervene and protect consumers from situations like these.



Activity

View television ads for one night or read the ads in a daily newspaper and comment on any unfair trading infringements in these ads.

You can refer to the Learners Guide for feedback on this activity.

You will now examine another disadvantage. You will remember that in the discussion on the free enterprise economic system, it was stated that there is little or no government interference in this type of economy. Mainly, the government had to provide merit goods. Do you think this is an advantage or disadvantage? You may argue that this is an advantage

because the government will provide these goods at a cheaper rate. Economists however, see this as a disadvantage because the private individuals and businesses only produce goods and services from which profit can be made.

You can now read more about the non-provision of public and merit goods and services below:

3. Non-provision of public & merit goods and/or services

In the free enterprise economic system, private individuals and firms do not provide public goods, such as roads, street lighting and national defense. In addition, merit goods, such as education, health care and transport, are inadequately provided. Public goods are not provided for two main reasons – non-excludability and non-rivalry. Non excludability means that it is not possible to provide a good or service to one person without it being available for others to enjoy. On the other hand, non-rivalry means that the consumption of a good or service by one person will not prevent others from enjoying it.

Huge profit may not occur from merit goods and, therefore, private firms do not invest in these ventures. Thus, if the provision of these utilities were left to the market or private enterprise, they would not be provided adequately or provided at all. Governments thus use public funds to build roads, restore parks, and provide street lights, education and health care services. When these amenities - street lights, roads and parks -are provided for, a particular individual and/or others can benefit from its operation without incurring personal cost.

Because of the high value it places on the profits, the free enterprise economic system cannot be relied on for the provision of public and/or merit goods and services.

The next disadvantage you will examine is inequality in the system. You will remember that in the free enterprise economic system private individuals and businesses control the economy. They determine the allocation of scarce resources to production, distribution and consumption and that the drive for profit is their main motivator. Therefore, who do you think would receive the greater income in this type of economy, the investor or the labourer? If you said the investor, you are correct because profit from investment is usually greater than the amount paid to a labourer. This difference between profits paid and labourer wages usually results in inequality in income. You can read more about this below:

4. Inequality in income distribution

Another major disadvantage of the free enterprise economic system is that it leads to a huge difference/disparity of incomes amount the different groups of people in the economy. For example, there is a tendency for the business and professional people, who may have a higher level of income, to be the ones to increase their wealth because

they have the means to do so. However, people with a low level of income spend almost all their money on meeting basic needs to survive so they do not have any available means to acquire further wealth. This is the troubling case of “the rich getting richer and the poor getting poorer” which many face. This problem may be aggravated in the free enterprise economy because there are little or no regulations regarding income distribution. It means that a small group of people may be able to enjoy the best goods and services while the majority of citizens may not be able to afford more than the bare necessities.



Activity

Name five occupations in which individuals gain high incomes. Now name another **five** occupations in which individuals earn low incomes.

Why do you think there is this gap?

You can refer to the Learners Guide for feedback on this activity.

You can use the acronym ‘**FUNI**’ to assist you to recall the disadvantages of the Free Enterprise Economic System.

- **F**ailure of businesses to self-regulate.
- **U**nfair trading practices.
- **N**on-provision of public and merit goods and/or services.
- **I**nequality in income distribution.

You will now identify countries that fall under the free enterprise economic system.

Example of a free enterprise economy

In reality there is no “pure” free enterprise/market economic system. The term is simply a concept on a continuum of extremes from a “pure” free to a planned economic system.

The United States of America is regarded as the closest example of a free enterprise/market economy. This is because most of the resources are owned and controlled by private individuals and firms. The investments of these private firms are used to create new products which generate further wealth. The price mechanism of demand and supply is used to determine the allocation of resources and there is little government intervention in answering the three basic economic questions.



Note it!

Every decision to fulfill a need or want involves making choices. Every time we begin to make choices we are in fact beginning to allocate resources.

You may now try the activity below:



Group activity

Now that you have identified the characteristics of the free enterprise economic system, you can engage in the following group activity. Divide the class into two groups.

One group will discuss the advantages they are likely to enjoy from living in a free enterprise economic system.

The other group will discuss the disadvantages of living in a free enterprise economic system.

Each group must select a leader and a scribe to do a presentation to the class.

You have 20 minutes for your discussion, and then you must be ready to make your presentation. Check the Learners Guide or get feedback from your tutor on the advantages and disadvantages of the free enterprise economic system.

Have fun!

Session Summary



Summary

In this unit you learned about economic systems.

- ✓ There are three major economic systems: the free enterprise, planned and the mixed.
- ✓ The main characteristics of the free enterprise economic system are:
 - resources are owned and controlled by private individuals and businesses
 - the main aim of production by private businesses is to earn profits
 - the private sector makes the economic decision of what

to produce, what resources are used and for whom these goods are produced

- the role of the government is limited to the provision of merit goods
- ✓ Advantages of the free enterprise economy include:
 - consumer sovereignty which results in production of a wide variety of goods and services
 - high efficiency in the use of resources as private businesses strive to lower costs of production and increase profits
 - increase in investment and innovation as businesses try to outdo competitors and bring new products to the market
 - profit as the motivating factor in determining what, how and for whom goods and services are produced
- ✓ Disadvantages of the market economy or free enterprise economy are:
 - its failure to regulate itself
 - capitalists may engage in unfair trading practices
 - public and merit goods and services are not produced since these goods and services do not earn high profits
 - inequality in income distribution is prevalent in this type of economy

Test your understanding of this session by completing the following activity.

Assessment



Assessment

Answer all of the questions below. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation. (Total of 10 marks - 1 mark for each correct answer.)

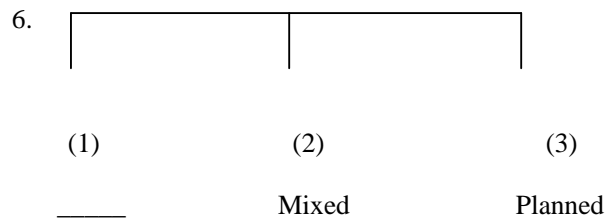
Choose the letter which corresponds with the most appropriate answer from the following ten multiple choice questions.

1. Which of the following type of economy is most likely to be a free enterprise economic system?
 - a. Japan
 - b. Libya
 - c. United States of America
 - d. China

2. Private businesses in a free enterprise economy are operated MAINLY to:
 - a. establish fair prices
 - b. make profits
 - c. provide goods and services
 - d. create employment

3. In a free enterprise economy, which factor determines what to produce?
 - a. government
 - b. consumers
 - c. investors
 - d. Resources

4. Which of the following is a characteristic of the market economy?
- there is fairness in the distribution of goods and services
 - private individuals are free to invest in any type of business
 - the individual as consumer is “king”
 - production and distribution of goods are done by the government
5. In a laissez faire economy, the goods and services are provided for the consumer by:
- the business sector only
 - the government only
 - the business sector and the government
 - committees set up by the government



The diagram above illustrates economic systems. To complete the diagram, show what should be included at (1).

- command economy
- control economy
- market economy
- subsistence economy

7. Which of the following goods or services will most likely NOT be produced by private individuals in a free enterprise economic system?
- a. food and clothing
 - b. roads and bridges
 - c. airline travel
 - d. housing
8. Which of the following are advantages of the free enterprise economic system? (Choose answer a, b, c, or d below.)
- (I) A wide variety of goods and services are produced.
 - (II) There is greater production efficiency.
 - (III) There is more investment and innovation.
 - (IV) There is equity in the distribution of goods and services.
- a. (I) only
 - b. (I) and (II) only
 - c. (I), (II) and (III) only
 - d. (I), (II), (III) and (IV)
9. Which of the following are disadvantages of the free enterprise economic system? (Choose answer a, b, c or d below.)
- (I) The market fails to regulate itself.
 - (II) There is likely to be unfair trading.
 - (III) Businesses may come together to set prices.
 - (IV) There is inequity in the free enterprise economic system.
- a. (I) only
 - b. (I) and (II) only
 - c. (I), (II) and (III) only
 - d. (I), (II), (III) and (IV)

10. A country in which the resources are privately owned and consumers have freedom to choose is called a

- a. free economic system
- b. closed economic system
- c. mixed economic system
- d. planned economic system

Total: 10 Marks

Session 3: The Planned Economic System

Introduction

In the last session we discussed the free enterprise economy. You can recall that the free enterprise system is only one way in which an economy can organise itself as it tries to answer the basic economic questions:

1. What goods and services should be produced?
2. How should goods and services be produced?
3. For whom should goods and services be produced?

In that system, individuals and private firms had the economic power and thus decided on how best to use the limited resources available to satisfy the needs and wants of the consumer. We also discussed that economic systems can be placed on a continuum, with the free enterprise economy at one end and the planned economy at the opposing end. Refer to Figure 15 in Session 2. In this lesson we will discuss the planned economic system.

Upon completion of this unit you will be able to:



Outcomes

Explain the planned economic system.

Describe the characteristics of the planned economic system.

Discuss the advantages and disadvantages of this system.



Terminology

Idle production: Resources that are available but not used in production.

Bureaucratic structure: A hierarchical organisational structure used by governments. There is a lot of “red tape” involved. This means before an action can be taken, it has to be passed through different heads of departments.

The Planned Economic System

The word “planned” means deciding on ways to achieve one’s objective. In other words, one is in a position to control one’s destiny. In a planned economic system, the government considers what is best for the welfare of society. Therefore, the government aims to provide adequate food,

clothing, shelter, education and health care for all of its citizens. The government thus allocates resources to the production of goods and services, and decides what goods, services and information should be consumed by the people.

The planned economy is a society in which the state or the government collectively decides what goods to produce and what factors of production should be used in producing goods for the people.

Another term used to describe the planned economy is the command economy.

Illustration of the Planned Economic System

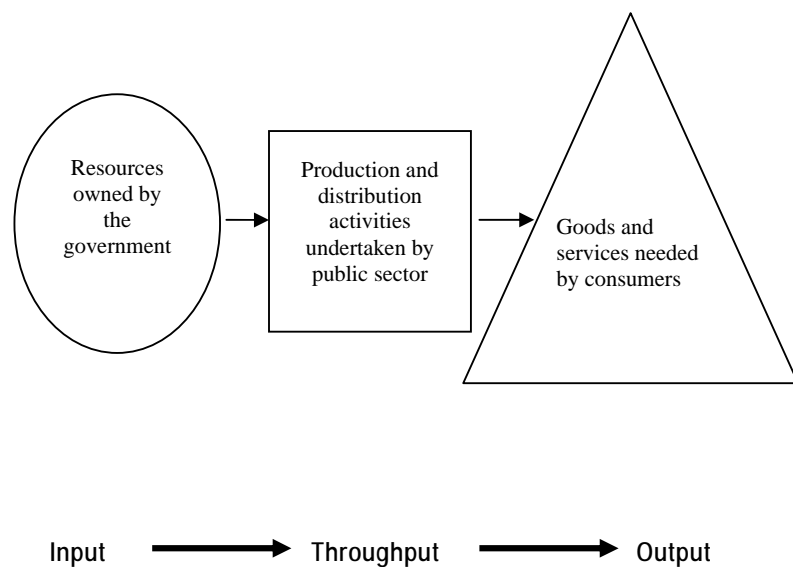


Figure 22

The input in the mixed economic system is resources owned by the government.

The throughput is the use of these resources in the public sectors where activities of production and distribution take place to ensure public welfare.

The output is the goods and services that are produced to meet the needs of consumers.

Characteristics of the Planned Economy

1. Ownership of resources.

There is public ownership of resources in a planned economy. This means that through the government, most of the land, factories, offices, machinery and technology are owned by the state. Thus, all citizens collectively own the resources but no one owns it individually. Unlike the free enterprise economy, there is little or no private ownership of resources, and businesses and private firms do not make the decision as to what to produce and for whom to produce. It is the state or the government that decides this.

The government is the main owner of the factors of production and thus receives the majority of earnings obtained from these factors of production.

2. Motive for production.

The aim of production is to maximize society's welfare by providing necessities such as housing, education and health care for the population.

The government relies on the collective efforts of the citizens, rather than on private individuals or private firms to produce what is needed for society; hence, the co-operative structure is the preferred choice for businesses. This is so because co-operatives are owned and controlled by the people and their aim is not to make a profit but to provide goods and services at minimum prices.

In fact, in previously planned economies such as Bosnia, until 1998, the citizens and state-owned companies paid relatively little for energy because the sector was state-subsidised. However, under the capitalist system, most state companies and individuals are in 2009 paying hefty bills for energy.

3. Role of government.

The government has a direct role in the planning of the economy. The government decides how the resources are allocated to production and how goods and services are distributed to consumers. To carry out these roles, planning committees are set up. These committees collect information on the quantity of goods, services and information that are required to fulfill the population's demand, thus arriving at an estimated figure. Using this information, the government allocates resources to different industries in keeping with its national plan.

If you are living in a planned economy, the government decides what you eat, where you work, the type of clothes you wear, the quality of housing, the sporting disciplines that the citizens should engage in, and the type of transport available.

The government provides and maintains the infrastructure and provides law, order and justice. The government also distributes the goods and services for its citizens.

For example, the government may decide that its major goal is the development of its human resources and thus invest heavily into health care, education, defence and social services, all towards providing a better quality of life for its people.



Figure 23: Children studying in class



Figure 24: Picture showing the distribution of goods to citizens

Source: http://upload.wikimedia.org/wikipedia/commons/thumb/a/a3/Distribution_of_BP-5_Emergency_food_packages_in_Goma_-_from_Flickr_2995064256.jpg/800px-Distribution_of_BP-5_Emergency_food_packages_in_Goma_-_from_Flickr_2995064256.jpg

4. The role of the private sector.

There is minimal involvement of the private sector; furthermore, the price mechanism plays only a minor role in this type of economic system since the government controls the prices of goods and services.

Prices are controlled and are usually set low enough so that all persons can afford to buy essential goods, services or information. For example, home rental prices are set very low to ensure that everyone can afford housing accommodation.

5. Choice.

There is limited freedom of choice since the government, through its central planning authority, decides what goods and services to produce. It means that for a particular product only a limited number of brands are produced. Some goods, such as cell phones and the internet, may not be available in large quantities in these economies.

Workers too may be limited in their choice of occupation since the government directs labour to production areas. For example, youths showing talent in certain sports may be encouraged to pursue sporting careers. It can also be observed that certain professional areas are highly developed. One such area is medicine because good health care systems are important in these economies.

On the other hand, the government may choose to invest heavily in defence. This is the case in China, where the defence budget has continued to rise over the last ten years.



Figure 25: The China Defence Force

Source: [http://en.wikipedia.org/wiki/File:Marines_of_the_People%27s_Liberation_Army_\(Navy\).jpg](http://en.wikipedia.org/wiki/File:Marines_of_the_People%27s_Liberation_Army_(Navy).jpg)



Group
activity

Discuss the role of the government in providing direct employment in your country. You should spend approximately 10 minutes on this discussion.

Advantages of the Planned Economic system

Advantages of the planned economic system:

You can use the acronym '**PEEL**' to assist you to recall the advantages of the planned economic system.

- **P**roper utilization of resources
- **E**quality is improved
- **E**nables full employment
- **L**ow prices for essential services

Proper utilization of resources

Since the government controls the majority of resources, it can plan how to properly utilize these resources in production. For example, the most fertile land may be allocated to agricultural use, while arid lands may be allocated to housing and/or industrial sites. The planners decide the best use to be made of the natural and human resources, and in doing so, they are used in the most efficient manner.

There may be little or no unemployment or unused resources because the government will ensure that production continues. Factories will not be closed if they are unprofitable, because profit is not the government's main concern. This proper utilization of resources allows the economy to develop in a steady manner.

Equality is improved

A planned economy serves social rather than individual ends. In other words, the government aims to meet the needs of all its citizens. Thus, under such a system, rewards such as wages or perks are distributed according to the social value of the service performed. For instance, if the society values health care, then health professional wages would be slightly higher than the sanitation worker. Nevertheless, wage differences among the categories of workers are not wide, that is, the gap between the wages of the doctor (professional) and the cane cutter

(labourer) is not as wide as in the market economy. In this way, therefore, this system promotes greater income and social equality than free enterprise economies.

Whereas in the free enterprise economy people produce for profit, leading to a rich minority group while the masses are relatively poor, in the planned economy the absence of the profit motive and the emphasis on providing for the needs of all result in greater equality among citizens.

Enables full employment

Generally, in planned economies the government strives to achieve full employment of its human resources. All workers are directed to productive activity by government planning. There is, therefore, no unemployment in this economy.

Low prices for essential services

The prices charged for essential services and basic necessities are relatively low because they are set by the government. These prices are set to only cover costs of production and do not include any profit. Do you know why? Recall that the aim of the government is not to make a profit, but rather is to ensure the welfare of citizens.

In order to keep prices low, the government may also provide subsidies for basic goods, such as food, housing, energy and education. Subsidies are monies given by the government to producers to help cover part of the cost of production. This helps to keep the prices of goods and services low enough so all citizens can afford to buy them.



Activity

Decide whether the following the statements are True or False. Discuss your answers with a classmate or with your tutor.

Write the word True or False in the space provided next to each statement.

1. The cost of energy is usually low.
2. The cost of food is usually high because the government has to import food.
3. There is little or no poverty because the citizens receive high wages.
4. There is usually full employment.
5. Individuals are free to choose their own careers.
6. There is equality in society because the emphasis is on social issues.
7. There are little or no idle resources.
8. The planning committee's role is to allocate resources to production.

Disadvantages of the Planned Economic System

You can use the acronym '**CIVIL**' to assist you to recall the disadvantages of the Planned Economic System.

- **C**omplacency
- **I**nefficiency in the use of resources
- **V**ariety is restricted
- **I**naccuracy in forecasting
- **L**ow quality of goods

Complacency

Workers often feel that their efforts will not be recognised and rewarded and thus a certain level of complacency exists in the system. This is because the lack of opportunity for people to earn profits may prevent them from being creative and motivated to work hard.

Inefficiency in the use of resources

Although planned economies boast of no unemployment, in reality, many workers are inefficient and unproductive. In some instances, they may be placed in job areas for which they are unskilled, untrained or not interested. In addition, worker “padding” may occur on job sites, that is, workers are placed on sites where they are not needed. When this occurs, inefficiency sets in because the human resources are not properly utilized.

In addition, valuable resources are diverted to administrative work involved in running the economy, and this contributes to the wastage of resources. Many persons are employed in the administration, supervision and distribution of goods and services, often resulting in unnecessary bureaucratic structures which may encourage corruption and wastage.

It is also argued that when resources are controlled by the state it reduces the effort and initiative of private individuals.

Variety of goods and services is restricted

Since competition among firms is not a main feature of this type of economy, there is a lack of variety. Consumers therefore have limited choices in the goods, services and information. The goods produced are what the government thinks are in the best interest of the population.

Inaccuracy in forecasting

Government officials determine the goods and services that consumers desire through surveys and forecasting based on previous years’ data. However, it is very difficult to determine the accuracy with which wants are estimated and resources allocated. It is impossible to predict accurately the satisfaction individuals will obtain from consuming different kind of goods. Determining the level of satisfaction the consumer will derive from a good or service is very subjective. This means that the level of satisfaction from consuming or using the same good varies from person to person.

A visit to a food court in a mall will show the variety of foods that are used to satisfy hunger. It is, therefore, difficult to accurately estimate the quantity of goods and services to produce. Hence, poor estimates may result in the inefficient use of resources. Some goods may be produced in surplus quantities while shortages may exist for other goods and services.

Low quality goods

The lack of the profit motive means that that there is little incentive for private investment and competition. In planned economies, factories and technology used are often over used, outdated and obsolete. This lowers the quality of various goods and services produced.



Group
activity

VIDEO/SKIT PRESENTATION

In your class groups (not more than 4 people) prepare a 4 minute script/video of a market economy being converted to a command economy.

In your skit, incorporate as many characteristics, advantages and disadvantages of both economic systems.



Note it!

In reality there is no totally planned economic system.



Activity

Identify a country within the Caribbean region that exhibits most of the characteristics of the planned economic system..

Can you think of an example internationally?

Examples of planned economies

There are rarely pure planned economies today but an example within the Caribbean region is Cuba. Internationally, there is the former Soviet Union, Poland and North Korea.

Session Summary



Summary

In this session you learned about the planned economic system.

- ✓ The characteristics of the planned economic system are:
 - the government owns and controls most of the resources
 - the motive of production in this economy is to maximize society's welfare by providing essential goods and services.
 - the government makes all the economic decisions on what to produce, for whom the goods and services are produced and how these goods and services are produced.
 - there is minimal involvement in economic activity by the private sector
 - people have limited freedom of choice.

- ✓ The advantages of the planned economic system are:
 - there is proper utilization of resources
 - there is greater equality of income among people
 - there is full employment of human and natural resources
 - the prices of essential services are relatively low

- ✓ The disadvantages of the planned economic system are:
 - complacency of workers
 - inefficiency may arise in allocation of resources
 - lack of variety of goods and services produced
 - inaccuracy in forecasting
 - goods and services produced may be of low quality

Assessment



Assessment

Answer all of the questions below. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Choose the letter which corresponds with the most appropriate answer from the following ten multiple choice questions.

1. Which of the following type of economy is most likely to be a planned economic system?
 - a. Barbados
 - b. Britain
 - c. United States of America
 - d. China

2. Planning committees in a planned economic system operate MAINLY to
 - a. provide private goods for the welfare of citizens
 - b. make profit for reinvestment in companies
 - c. provide goods and services a low prices
 - d. create employment for citizens

3. In a command economy, the factor that determines what to produce is
 - a. the government
 - b. consumers
 - c. investors
 - d. Resources

4. Which of the following is a characteristic of the planned economy?
- a. there is equity in the distribution of goods and services
 - b. private individuals are free to invest any type of business
 - c. the individual as consumer is “king”
 - d. the private individual decides what to produce
5. In command economy, the goods and services are provided for the consumer by
- a. the business sector only
 - b. the government only
 - c. the business sector and the government
 - d. the committees that are set up by businesses



The diagram above illustrates economic systems. To complete the diagram, show what should be included at (1).

- a. command economy
- b. free economy
- c. market economy
- d. money economy

7. Which of the following goods or services will MOST LIKELY be produced in the planned economic system?
- (I) food and clothing
 - (II) roads and bridges
 - (III) education and health care
 - (IV) housing and luxury cars
- a. (I) only
 - b. (I) and (II) only
 - c. (I), (II) and (III) only
 - d. (I), (II), (III) and (IV)
8. Which of the following are advantages of the planned economic system?
- (I) There is proper utilization of resources.
 - (II) There is greater equality in incomes.
 - (III) There is usually full employment.
 - (IV) The cost of essential goods and services are low.
- a. (I) only
 - b. (I) and (II) only
 - c. (I), (II) and (III) only
 - d. (I), (II), (III) and (IV)

9. Which of the following are disadvantages of the planned economic system?
- (I) The system encourages complacency
 - (II) There is inefficiency in the use of resources
 - (III) The system restricts a wide variety of goods and services.
 - (IV) There is inequity in incomes between professionals and wage earners
- a. (I) only
 - b. (I) and (II) only
 - c. (I), (II) and (III) only
 - d. (I), (II), (III) and (IV)
10. A country in which the resources are owned and controlled by the government and consumers are restricted in choosing goods and services is called a
- a. free economic system
 - b. closed economic system
 - c. mixed economic system
 - d. planned economic system

Total: 10 Marks

Now let us turn our attention to the third major economic system, that is, the mixed economic system which you will learn about in Session 4.

Session 4: The Mixed Economic System

Introduction

In Sessions 2 and 3 you learnt about the free enterprise and planned economic systems and how they attempt to address the economic problem of scarcity. Be aware that in reality no country has either one hundred percent free enterprise or one hundred per cent government control. In our modern day economy, all countries tend towards a combination of the free enterprise and the planned economic systems.

Does your country have secondary schools run by both the government and private organisations? If you are sick, do you have the option to go to a public hospital or to a private medical institution, providing you have money to pay for the latter? If you answered yes to both questions, then you most likely live in what is called a mixed economic system.

This session will discuss the mixed economic system, which contains characteristics from both the free and planned economic systems. You will see how the mixed economy attempts to solve the economic problem of scarcity and address the resource allocation questions of what, how and for whom to produce goods and services.

Upon completion of this unit you will be able to:



Outcomes

Distinguish between the public and private sectors of a mixed economic system.

Explain how the mixed economic system addresses the three resource allocation questions.

Identify the characteristics of the mixed economic system.

State the advantages and disadvantages of a mixed economic system.



Terminology

Private sector: The part of economic activity in a country where business organisations are privately owned and controlled.

Public sector: The part of economic activity in a country where organisations are owned and controlled by the government

All countries in the world tend towards a combination of strategies used in free enterprise and planned economic systems, to deal with the economic problem of scarcity. This has resulted in the formation of the

mixed economic system.

What is a Mixed Economic System?

A mixed economic system exists when economic activities of a country are undertaken by both privately owned businesses and government to produce goods and services to satisfy the needs and wants of consumers.

In the continuum of economic systems that you examined in Session 2 of this unit, a mixed economic system is one that lies between the two extremes of the perfectly free enterprise and the perfectly planned economic systems. Since there are no perfectly free or planned economic systems in reality, it is safe to say that all countries have varying degrees of mixed economic systems.

There are two main sectors in the mixed economic system:

i. The private sector: This consists of privately owned businesses which operate mainly to make profit by producing and selling what consumers want to buy.

ii. The public sector: This consists of government owned organisations which operate mainly to ensure public welfare.

To continue with the illustration used in the previous sessions, the mixed economic system can be represented by the diagram shown below.

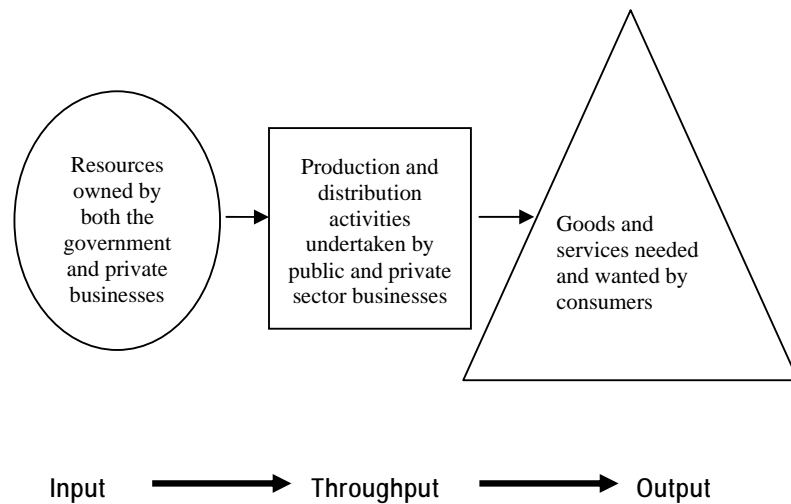


Figure 26: Illustration of the Mixed Economic System

The input in the mixed economic system is resources owned by both government and private businesses.

The throughput is the use of these resources in the public and private sectors where activities of production and distribution take place to ensure public welfare and to make a profit respectively.

The output is the goods and services that are produced to meet both the needs and wants of consumers.

Resource Allocation in the Mixed Economic System

What goods and services to produce

This decision is made by both the private and public sectors in a mixed economic system.

The private sector lets the market serve as an indicator of how resources are to be allocated and what goods and services will be produced. This is similar to what occurs in the perfectly free enterprise economic system, which you learnt about in session two. The goods and services that consumers want and are able to buy will be produced by privately owned businesses once profits can be earned.



Activity

Make a list of six goods and services that are produced by private businesses in your country.

Your list may include goods like shoes, clothes, food, electronics, vehicles and household appliances, and services available at beauty salons, recreation clubs and restaurants. Does it? What do you notice about your list? These goods and services are bought to gain personal satisfaction or ownership and are known as private goods. Private businesses sell them to make profit.



Reflection

So what about goods and services that are not produced by private businesses? How do you think people will access them?

Are you thinking about the government? That's correct.

In the mixed economic system, the government plays a part in deciding what to produce. In the public sector, resources are allocated to make goods and services that are not produced by the private sector and which

will benefit everyone in the society.



Activity

Make a list of six goods and services that are produced by the government of your country.

Most likely your list will include health care, education, defense services by the police and army, administration of justice, and the transportation network of roads, bridges and street lighting.

Did you notice that these goods and services benefit everyone in society? They are provided by the government, either at no cost or at a minimal price, to benefit society rather than to make profit.

The degree to which private enterprises and government intervention is mixed varies from country to country. Some governments may establish businesses to operate with private sector criteria and to generate revenue for the country. For example, in Trinidad and Tobago the government owns the oil refinery and the national airlines, which produce private goods and services and are expected to make profit to remain in existence.

In many mixed economic systems both private and public sectors may sometimes produce similar goods and services.



Reflection

Can you think of examples of goods and services which are produced by both private businesses and the government in your country? Why is this possible? You can share your ideas with your classmates/tutor.

Check if you had some of these examples:

In education there may be private and public schools; in health care there are government hospitals as well as private medical institutions; in security services the government provides national security but private security firms offer personal protection services at a price.

Are you seeing a trend? Many goods and services which were formerly only provided by the government are now being sold by the private sector. This occurs if there is a need and if consumers are willing to pay for them. This enables the private sector to make profit and to allocate resources to assist in filling any shortfall of the public sector. For example, when public hospitals cannot efficiently meet the health needs of the public, private medical institutions thrive because people who can pay for health care will do so.

How to produce goods and services

In the mixed economic system, the main aim of the private sector is to achieve efficiency in production in order to maximize profit. Private businesses thus seek to acquire resources and technology at the lowest cost possible. They combine these to produce the greatest output and achieve the highest profit possible. The combination of resources used will depend on the nature of individual businesses in the private sector.

In the public sector, the main aim is to ensure the welfare of all people. Sometimes the government may choose to allocate its resources in a less than efficient manner if this will improve the welfare of its citizens. Thus for example, if a country has a large amount of unemployed labour, the government may choose to employ these persons at a relatively higher cost, than to use machines and technology which will leave these persons unemployed. This is because many public sector organisations tend to have non-profit motives and the government will continue to finance their operations in the interest of the welfare of society.

Do you think that the government has any influence over how goods and services are produced by the private sector? I am sure that you answered yes. Let us examine this further.

In mixed economic systems, government plays a key role in setting regulations which govern the type of private businesses that can be established and where they can be located. Laws also set standards that businesses must meet in order to safeguard the interests of workers and consumers and to protect the environment. You will explore these in greater detail in the Unit 2.

Sometimes how private businesses produce can be enhanced by assistance from the government. Some types of assistance include loans, special grants, tax reductions, or education and training for workers to develop skills

Another important point to note is the fact that efficiency of production in the private sector can be affected by how the public sector produces its own goods and services. For example, the supply of public utilities, such as water, electricity, infrastructure, transportation and communication networks, that are provided by the public sector impact the way in which private businesses conduct their activities. If these are efficiently provided, it helps to lower costs and speed up production for private businesses.

For whom to produce goods and services

In the mixed economic system, both market and government decisions determine for whom goods and services are produced.

Private businesses produce for consumers who can pay for what they want. For example, if people are willing to buy luxury yachts and they have the money to do so, businesses will produce luxury yachts.

The public sector produces for the general public to satisfy their needs, whether or not they are able to pay for them. For example, the

government will supply free of charge services, such as streetlights, postal services, road maintenance and police patrol, so everyone can benefit.

Characteristics of the Mixed Economic System



Activity

Now that you are familiar with how the mixed economic system addresses the three basic economic questions of what, how and for whom to produce, you can attempt to identify its main characteristics. Use the table below to fill in the information. The first row has been done for you. When you are finished you can check the Learners Guide or with your tutor for the characteristics of the mixed economic system.

Characteristics of the Mixed Economic System	
Ownership of resources and businesses:	Resources are owned by both private businesses (private sector) and the government (public sector). The extent of ownership usually varies in different countries.
Motive for production:	
Choice:	
Role of government:	
Role of private businesses:	
Examples of countries with mixed economic systems:	

Figure 27: Characteristics of the Mixed Economic System

Advantages and Disadvantages of the Mixed Economic System



Discussion

Together as a class, review the disadvantages of the free enterprise and planned economic systems. Discuss if and how these disadvantages were solved in the mixed economy. Are any advantages of the free enterprise and planned economic systems that are still present in the mixed economy? Discuss the ones you identified.

You can check the points you identified with those presented below.

Advantages of the Mixed Economic System
1. All persons enjoy freedom of choice. Individuals are free to work, buy and consume what they desire within the laws which are implemented by the government to ensure their personal safety. Such laws may include age limits for consumption of alcohol and bans on smoking in public.
2. Both needs and wants of persons are met. The public sector provides public and merit goods and services needed to ensure public welfare, while the private sector supplies a wide variety of private goods and services to cater to the personal wants of persons.
3. The government can use laws to regulate the private sector businesses and prevent them from exploiting persons as consumers and workers.
4. Private businesses are able to enjoy a great deal of freedom in decision making as long as they operate within the limits of the laws, which are designed to protect the interest of the public.
5. Governments can work with and provide assistance to private businesses to promote investment and generate employment opportunities.
6. Private businesses benefit from the infrastructure that the government provides, for example, the transport and communication networks, water and power supplies.
7. Governments can adopt policies to ensure efficient use of the country's resources and achieve desired goals for overall development of the country, without having to undertake all economic activities on its own.

Figure 28: Advantages of the mixed economic system

You will realise that the mixed economic system is, to a large extent, able to eliminate the disadvantages of the free enterprise and planned economic systems and adopt their advantages.



Reflection

Is the mixed economic system perfect? Are there any disadvantages in using this system to allocate resources?

See if you came up with any of the following.

Disadvantages of the Mixed Economic System
1. Sometimes public sector organisations may not use resources as efficiently as the private sector. As a result, costs of production may be higher than they should be and taxpayers will have to bear the burden.
2. Increased taxes charged to support inefficient public sector organisations can have a negative impact on private businesses and how much consumers can buy.
3. Excessive monitoring and control of private sector activities by the government can sometimes discourage private investment. This will have a negative impact on employment and national output.

Figure 22: Disadvantages of the Mixed Economic System

The disadvantages that mixed economic systems may experience depend to a large extent on the degree of control exerted by the public and private sectors. Countries need to try to find just the right combination of private and public sector activities in order to truly benefit from a mixed economic system. Usually with time and through trial and error countries can achieve the right mix that is suitable to their unique situations. The mere fact that all countries are mixed economic systems testifies to the advantages of this type of economy.

Session Summary



Summary

In this unit you learned about the mixed economic system.

- ✓ All countries in the world have mixed economic systems, but the degree of the mix varies. The mixed economic system consists of a private sector and a public sector.
- ✓ The private sector is guided by the market to allocate its resources and produce goods and services that consumers are able to buy. The main motive is to make the highest profit possible and businesses try to keep production costs low so this can be achieved.
- ✓ The public sector focuses on using the resources owned and controlled by the government to produce the goods and services necessary for the welfare of its citizens.

Assessment



Assessment

Answer all of the questions below. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

There are three questions in this assessment.

- Each correct response in question # 1 will score one mark for a total of five marks.
- Each correct response in question # 2 will score one mark for a total of five marks.
- The marks are stated in each part of question # 3 for a total of ten marks.
- The total marks for the assessment is **20 marks**.

You should spend a maximum of thirty minutes on this assessment.

1. In this assessment you should be able to classify the examples of the following business activities into public sector or private sector. Read the business situations below and indicate if they will be undertaken by the public or private sector.
 - a. The hospital provides free health care services for citizens.
 - b. John imports roll-on roll-off cars from Japan for his business.
 - c. The National Housing Agency provides homes for citizens.
 - d. The fishermen of a village produce salted fish and shark oil.
 - e. The public transport service is operated by the government.

(5 marks)

2. This assessment will reinforce your understanding of mixed economies. The following sentences describe information relating to the mixed economy. Decide whether these statements are true or false.

- a. The private sector is operated by the government.
- b. There is a wide variety of goods and services in the mixed economy.
- c. Cuba and China function using a mixed economic system.
- d. Essential goods and services are provided for all citizens by the private sector.
- e. In a mixed economy the government regulates the activities of businesses operating in the private sector.

(5 marks)

3. Explain how the private sector decides what goods to produce.
(2 marks)

4. Explain TWO differences between a planned economy and a mixed economy.
(4 marks)

5. Discuss ONE advantage and ONE disadvantage of the mixed economy.
(4 marks)

Unit Summary



Summary

In this unit you learned about the development of economic systems. You traced the development of economic activity from the early days of civilisation to our present day modern economy. You became aware of the basic economic problem of scarcity and examined three types of economic systems that address the questions of what, how and for whom to produce goods and services.

The table below summarises the main features of these three economic systems: the free enterprise, the planned and the mixed economic systems.

Features of the three types of Economic Systems			
Features	Free enterprise Economic System	Planned Economic System	Mixed Economic System
Who owns resources	Private persons and businesses	Government or state	Both private businesses and government
Main aim	Businesses: to earn the highest profits Consumers: to get greatest satisfaction or utility	Collective welfare of all persons in society	Private sector: to earn highest profits Public Sector: to ensure safety and welfare of all persons
What goods and services to produce	Those that consumers will buy as indicated by the market	Those that the government dictates are needed for collective welfare	Private Sector: what the market signals Public Sector: what the government specifies
How to produce	Combine resources to get highest output and at lowest cost so the highest profit possible is made	Combine resources to produce enough to meet needs	Private sector: combine resources to get efficiency in production and highest profit Public sector: use resources to ensure greatest welfare benefits for all
For whom are goods and services produced	Persons willing and able to buy	For persons as directed by the government	Private Sector: for persons who can buy

Features of the three types of Economic Systems			
Features	Free enterprise Economic System	Planned Economic System	Mixed Economic System
			Public Sector : for all persons
Main advantages	<p>Freedom of choice for persons as consumers, workers and investors</p> <p>Wide variety of products to satisfy wants of consumers</p> <p>Personal incentives to work</p> <p>Profit motive contributes to efficiency</p> <p>Competition encourages low prices and high product quality</p>	<p>Duplication of production prevented by central planning</p> <p>Needs of persons are satisfied</p> <p>Facilitates overall and long term planning for the country</p>	<p>Freedom of choice</p> <p>Both needs and wants of persons can be satisfied</p> <p>Government regulations protect persons from exploitation by private businesses</p> <p>Government assistance encourages private enterprise</p> <p>Competition encourages low prices and high quality product</p>
Main disadvantages	<p>Duplication of production can cause waste of resources</p> <p>Inequalities in wealth</p> <p>Public and merit goods not produced</p>	<p>No freedom of choice for persons</p> <p>Slow decision making</p> <p>Lack of competition prevents improvements in production methods and product quality</p>	<p>Excessive government control and regulations can discourage private enterprise</p> <p>Public sector organisations may be inefficient</p>
Example	Closest example: USA	Closest example: Cuba	All countries

Figure 23

Assignment



Assignment

You have now completed your study of Unit 1: Development of Economic Systems. You were able to identify the methods used to satisfy the needs and wants of man from the early days of civilization to our present day modern economy.

You will now apply what you have learnt to complete the questions contained in this assignment. The total possible marks you can score are twenty. You should spend a maximum of thirty minutes on this assignment.

Guidelines for doing the assignment:

- Use the knowledge you acquired from the content of the four sessions of Unit 1 and apply it to the scenarios presented in the questions of the assignment.
- Remember that you should not just rewrite the points. You need to explain them in the context of the situations described in the questions.
- Your responses must be in clear simple sentences.
- Submit your assignment.
- Your tutor will grade this assignment.

Take an imaginary journey back to the early days of civilization when a subsistence economy existed. You are one of the three persons trying to directly produce everything you need to satisfy your basic needs. Eventually each person decides to specialise and do what he/she is best at. You become a hunter, one person concentrates on growing crops and the other becomes a fisherman.

- (a) Describe the system of exchange that would enable each person to get the three types of food items after specialization took place. (6 marks)

- (b) State three major problems that would be encountered with the system of exchange you described in the above question. (6 marks)

Now return to our present day modern economy with its wide range of economic activities in areas like production and distribution.

- (c) Explain the exchange process that now exists to enable people to get the numerous goods and services that are available, without each person having to directly produce them. (6 marks)

Your online friend, who lives in a planned economic system, has expressed the desire to live in a mixed economic system like you do. She wants to know how your country answers the three basic resource allocation questions of what, how and for whom to produce.

- (d) Prepare the response that you will send to your friend to highlight the main characteristics of the mixed economic system. Be sure to explain the measures put in place to answer the three basic resource allocation questions. (6 marks)
- (e) In your reply include two advantages that your friend will enjoy in a mixed economic system that are not available to people in a planned economic system. (6 marks)

Total: 30 marks

When you are finished this assignment, submit it to your tutor for evaluation. You may be asked to include the session assessments you have completed and self-marked.

Unit 2: The Business Environment

Introduction

In Unit 1, you examined how economic systems address the economic problem of scarcity to answer the questions of what, how and for whom to produce. This unit will take a closer look at the environment within which businesses operate in the mixed economic system which is the system used by most countries. Today thousands of businesses exist, varying in size and nature of operations. However they all perform the economic function of acquiring and organising resources to produce goods and services for sale to satisfy the needs and wants of persons.

Session 1 will present a general overview of the roles of businesses and highlight their importance in the mixed economy. In Session 2 our attention will switch to the internal and external business environment. You will examine the external environment in terms of its political, economic, social and technological influences to see how these affect what happens within a business. In session 3 you will look at stakeholders who are persons or organisations that affect or are affected by business activities. Session 4 will give general guidelines that businesses need to follow to meet the legal requirements of a country.

Upon completion of this unit you will be able to:



Outcomes

Describe the roles of business in a mixed economy.

State reasons why a person establishes a business.

Identify factors which exist in the internal and external business environment.

Explain how factors in the external environment affect business.

Discuss stakeholders in business activities.

State the legal regulations governing business organisations.

The sessions in this unit are:

Session 1: The Role of Business in a Mixed Economy

Session 2: The internal and external business environment

Session 3: Stakeholders in business

Session 3: Legal guidelines for business operations

Time Frame: Fifteen hours (15 hours)

Session 1: The Role of Business in a Mixed Economy

Introduction

Imagine all the businesses in your country were closed for one week, then a month. Would you be able to continue living the lifestyle you have grown accustomed to? How would you get food, clothes, transport or even entertainment? Where would people work to get money? What would you be able to buy if nothing is for sale? Trying to answer these questions gives you an idea of what we often take for granted. Businesses are essential to our modern day lives.

What motivates people to risk their money and undertake business ventures? Why do governments encourage the establishment of private businesses and directly engage in business activities themselves? What roles do businesses play to give them such importance? Think about the last purchase you made at a business. What was the function of this business? Does it have any function besides providing people with goods to purchase? Or, are others and even the country benefiting from its operations in different ways?



Terminology

Standard of living:

The amount of goods and services that a person is able to enjoy. This also refers to a person's overall quality of life.

Wealth:

The sum total of all material goods and assets possessed.

Tax:

A compulsory payment made to the government for which no direct benefits are received.

In this session you will examine why businesses are established by both private persons and the government. You will identify the roles of businesses and, equipped with this knowledge, you will be able to appreciate their importance to both individuals and society.

Upon completion of this session you will be able to:



Outcomes

Explain what a business is.

State why persons may establish a business.

Describe the roles of businesses in a mixed economic system.

What is a Business?

This is a business course and the term business has been used so far with the assumption that everyone knows what it is. It is now time to take a closer look at a business.

Like an economic system, a business is also a system. Recall the concept of a system that you learnt about in Unit 1 as we now apply it to a business.

Examine the illustration below.

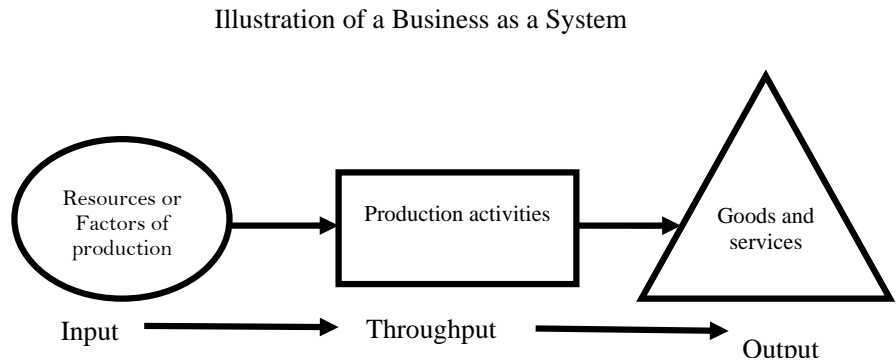


Figure 1

In the illustration you can see that, as a system, the input in a business refer to the resources or factors of production. Throughput is the different activities applied to the resources to get the output of goods and services.

Examine the following pictures shown in Figure 2, which are based on a business operating as a restaurant.



Fresh vegetables

Source:
http://farm2.static.flickr.com/1086/1171626405_2caa8dcd8f.jpg



A prepared meal

Source:
[http://upload.wikimedia.org/wikipedia/commons/e/e0/Halibut_with_mango_salsa_on_coconut_brown_rice_\(434662467\).jpg](http://upload.wikimedia.org/wikipedia/commons/e/e0/Halibut_with_mango_salsa_on_coconut_brown_rice_(434662467).jpg)



Chefs at Work

Source:
http://upload.wikimedia.org/wikipedia/commons/1/19/White_House_chefs_1981.jpg



Collecting money from customers

Source:
http://farm1.static.flickr.com/182/472622607_01d79a4723.jpg



Serving meals to customers

Source:
http://farm4.static.flickr.com/3051/3049808620_0df2eebfda.jpg

Figure 2: Pictures of activities at a restaurant

Using the table below in Figure 3, write the name of the picture that should go under the headings of input, throughput and output.

Input: Resources/factors of production	Throughput: Production activities	Output: Goods and services produced

Figure 3

Check your responses with those suggested in the table below.

Input: Resources/factors of production	Throughput: production activities	Output: goods and services
Fresh vegetables Stove Electricity Cash register Tables Chairs Workers Money	Buying the input Preparing the food Serving customers Managing the workers Selling the food Managing the money	Cooked meal

Figure 4

Do you think you can now give a definition of a business? See if what you are thinking matches the one below.

A business is an organisation that uses resources and engages in production activities which result in goods and services to be offered for sale.

Businesses vary in many ways, such as the sizes and types of output. However, they all have the three elements of the business system in

common. From the vendor selling newspapers, to the small boutique, to the medium size supermarket, to the large international business, they all need resources and undertake production activities to produce goods and/or services. You will learn more about these in subsequent units.

You will now focus on why people establish businesses.

Why Establish a Business?



Reflection

Would you like to start your own business? Give reasons for your answer.

If you answered yes, your reasons probably include the desire to make more money or to be your own boss.

If you answered no, you probably prefer to earn money by working for someone else and do not wish to take on the responsibilities of having your own business.

Do you think people who have started their own businesses once had reasons similar to yours?

A few successful business peoples in the community of Princes Town in Trinidad were asked the following question:

“Why did you go into business?”

These were some of the responses:

- “I had an idea for a product that I knew people would want to buy, and saw the opportunity to make money.”
- “I was fed up working for others. I wanted to be my own boss, make money and maybe even have other people work for me.”
- “I inherited this business from my father. I couldn’t let my family down and, anyhow, the business is popular and we make good money.”

From the above responses, what was the main reason the three persons gave for starting their own business?

Did you notice that all three persons said they wanted to make money? Technically in the business world this really means earning profits. In the last unit, you saw that private sector businesses are profit driven. People

usually establish businesses and continue to operate them once they can make a profit.

A business usually begins with an idea. After doing some research into the potential success of this idea, a person may decide to establish a business. This move will enable the person to achieve both intrinsic and extrinsic satisfaction. Let us examine these two terms.

Intrinsic satisfaction:

Intrinsic satisfaction refers to the basic pleasure people get from doing something that they really want to do. This is not measured in terms of money but is an expression of a person's feeling of self-fulfillment.

For example, some people may set up a business because of the satisfaction derived from pursuing an idea and fulfilling a dream. Or the business may be an opportunity to use their skills and talents in a meaningful and satisfying way. The prestige enjoyed from owning a successful business may be another source of motivation for establishing a business. However, despite these intrinsic reasons, to remain in business a person must also gain extrinsic satisfaction.

Extrinsic satisfaction:

Extrinsic satisfaction refers to material or measurable rewards of doing something. Here is where the aim of making a profit acts as the incentive to establish a business. Ownership of a successful business can help a person gain financial independence and increase wealth. A business owner who works in his own business can enjoy profit earned as well as the salary he pays himself.

The Role of Business in a Mixed Economy

You will recall from unit one, that a mixed economy is one in which economic activities are undertaken by businesses operating in both the private and public sectors. Apart from personal benefits received by individuals, businesses make important contributions to the society and country in which they operate. You will now examine these roles and benefits.

The role of business:

1. Businesses make use of a country's resources to create useful goods and services. You will recall that businesses allocate resources to produce an output of goods and services which can satisfy needs and wants. Output can be classified in two categories: producer goods and consumer goods.

Producer goods are those that are used by businesses to enable further production to take place, for example, all the tools, machines and man-made products that are used in production. These are also called capital and a more in-depth analysis of this will be done in Unit 4.

Consumer goods are used directly by people to satisfy their needs and wants, e.g., food, books and electronics.

Note that sometimes the same product can be a consumer and a producer good; it depends on what it is used for. For example, a stove used to prepare meals for your family is a consumer good, while a stove used in a restaurant to prepare food for sale is a producer good.



Reflection

Think of other examples of items which can serve as both producer and consumer goods. What is the value of production of these goods to an economy?

See if you thought about these points:

Firstly, producer goods facilitate and enhance production and serve as an incentive for the establishment of businesses. More businesses operating increase a country's level of economic activity and contribute to its economic development. This can help countries to move closer towards developed status.

Secondly, a wide range of consumer goods enables people to satisfy needs and wants. These goods have become part of our daily existence to attain the standard of living we desire and can afford. Think of all the different types of food, clothes, electronic devices, vehicles, household appliances and services like banking, insurance, entertainment, travel and communication that are offered for sale. Businesses make these possible and they positively impact the standard of living that people can enjoy.

2. Profits earned by businesses serve as an incentive to remain in business and to undertake new ventures. When businesses are profitable, owners benefit and several options become available to them. Only two options will be addressed in this session.

Firstly, owners can increase their wealth and buy more goods and services to enjoy a higher standard of living.

Secondly, profits can be reinvested in the business. This will increase the amount of money available to continue financing and expanding business operations. Profit will also serve as an incentive for businesses to undertake research and develop new products that may benefit the wider community.

3. Businesses generate employment, which provides income for employees. In order for businesses to operate, people are needed to perform various jobs and functions. Employment opportunities serve as an incentive for people to acquire necessary skills and qualifications. This improves the skills base of a country's population and can lead to positive economic and social benefits. Let us examine these.

Think of people you know who are employed. Consider how many of them have jobs in business.

A safe guess is that the majority of people who do not work for the public sector either own a business or work for one in the private sector.

What is the value of employment to individuals and society?

People who are employed receive wages and this money benefits both individuals and society.

Firstly, individuals use the money earned to buy goods and services and enjoy the standard of living they desire and can afford. Also, saving some of their money can help them to achieve life plans, such as making major purchases, financing education, or investing in business ventures. All this contributes to an improvement in the quality of life.

Secondly, when employed persons use their money to purchase goods and services, they boost business activity. Businesses will have an incentive to increase the quantity, quality and range of goods and services produced. As a result, more persons will be employed, new businesses may be established and the earning and spending of money will continue. All this will result in a multiplier effect and contribute to the economic growth and development of the country. You will learn more about this in Unit 25.

4. **Business activities generate tax revenue for the government of a country.** You will learn more about taxation in Unit 22, but for now you will see how businesses help to provide tax revenue for the government.

Incorporated businesses are required to pay corporation taxes on annual profit earned. The actual percentage of tax and the minimum amount of profit on which it is levied varies from country to country. For example, presently in Trinidad and Tobago the corporation tax rate is 25 percent and the minimum annual profit level is two hundred and fifty thousand dollars. Thus the more profitable the business, the more revenue the government will receive. In 2009, commercial banks in Trinidad and Tobago each paid over one million dollars in corporation taxes. This gives you an idea of the significant amount of revenue that businesses can collectively contribute to a country.

Businesses also contribute significantly to other types of tax revenue for the government. Purchase taxes, which are also known as value added tax (VAT), are charged when certain goods and services are bought. Businesses collect this from customers and remit the money to the government. Workers also pay income taxes, which are deducted directly from their salaries and forwarded by employers to the government. Thus the more sales and employment generated by businesses, the greater the government's tax revenue will be.

The government uses tax revenue to finance its overall expenditure in the country and indirectly everyone will benefit. So when essential goods are sold at relatively low prices or public and merit goods are provided free by the government, these are examples of the tax revenue at work for everyone's benefit.

5. **Many businesses engage in international trade, conferring benefits on both individuals and the country's economy.** You will learn details about international trade in Unit 26. However, let us briefly examine what happens when businesses produce surplus or extra output that can be sold or exported to other countries. How does a country benefit from this?

Exports provide businesses with access to wider markets and enable a country to earn foreign exchange. Let us examine each of these points individually.

Access to wider markets: When businesses know that more people will buy the goods and services produced, there is an incentive for them to expand operations to produce more. This will result in the benefits that were outlined previously. Do you remember what these were? You can review them.

Earn foreign exchange: Foreign exchange earned from exports can be used to import or buy goods and services that cannot be produced

locally or are produced in insufficient amounts. This will have positive effects on both production and consumption in the country.



Discussion

Discuss benefits that businesses and consumers can enjoy when foreign exchange is used to import goods and services.

Check the points you raised with the following:

From the perspective of production: Businesses will be able to import capital equipment and raw materials that can be used to enhance and diversify local production. For example, the flour industry in Trinidad relies on imports of wheat from the United States of America and Canada in order to be able to produce flour, which is a staple in the diets of most Trinidadians. Also, the majority of electronic equipment and machines that are used in businesses in developing countries are imported from technologically advanced countries like Japan, Germany and the United States of America.

From the perspective of consumption: Businesses will be able to import goods to sell locally. People will have the opportunity to buy a wider range of goods to satisfy their needs and wants and contribute to an improvement in living standards. However, it must be noted that imports of goods should not adversely affect local production. The responsibility thus falls on the relevant authorities to monitor the situation and prevent any negative effects on local businesses.

6. **Businesses often contribute to social development in countries.** In recent times many businesses have recognised the importance of giving something back to the society in which they operate. Thus a new role of social or corporate responsibility has emerged. This is evident in the contributions that the business sector makes to the development of the community in which they operate. Areas of assistance include making charitable donations, sponsoring cultural and sporting activities, granting scholarships, providing opportunities for internship and on-the-job programs for youth and upgrading public areas in the community, such as schools and playgrounds. This has become a valuable role that businesses play in the social development of individuals and society.

Now you are aware of why people set up businesses and the benefits that they, as well as others, can enjoy. In Units 10, 20 and 30, you will learn how to prepare a business plan for a business you may wish to establish.

Session Summary



Summary

In this unit you learned what a business is. You also examined why people establish businesses and the benefits conferred on society.

- ✓ Reasons why persons may establish a business include the following:
 - To gain intrinsic satisfaction, such as self-fulfilment, by successfully pursuing a dream, achieving self-actualisation from doing what one is best at and gaining prestige.
 - To gain extrinsic satisfaction, such as financial independence and an increase in wealth.
- ✓ The benefits and roles of business include:
 - To utilise a country's resources to create useful goods and services. This facilitates further production and also allows people to satisfy their needs and wants.
 - To generate and provide employment.
 - To generate tax revenue for the government. The government uses this revenue to finance its overall expenditure in the country, from which everyone will benefit indirectly.
 - To engage in international trade, gaining access to a wider market and the opportunity to earn foreign exchange. When foreign exchange is earned from exports, it can be used to buy goods and services that cannot be produced locally or are produced in insufficient amounts
 - To honour their social or corporate responsibility. This is evident in the contributions made to the social and cultural development of the community in which they operate.
- ✓ All these roles that businesses perform contribute to improving the standard of living and promoting the economic growth and development of society.

Assessment



Assessment

Please review the information from this session and complete the following questions in both Sections A and B.

Section A consists of ten multiple choice questions. Read each question carefully and circle the letter which corresponds with the most appropriate answer from the four possible choices. Each correct response will be awarded one mark for a possible total of ten marks.

Section B is a structured question for a total of ten marks.

Section A:

1. The main aim of businesses operating in the private sector is
 - (a) to utilise resources.
 - (b) to make a profit.
 - (c) to increase the standard of living.
 - (d) to maximise the risk of enterprise.
2. Profit refers to
 - (a) excess revenue over costs.
 - (b) excess costs over revenue.
 - (c) excess expenditure over income.
 - (d) excess income over expenditure.
3. The main aim of businesses in the public sector is
 - (a) to increase capital available.
 - (b) to make a profit.
 - (c) to provide public goods.
 - (d) to ensure collective welfare of citizens.
4. Which type of goods enable further production to take place?
 - (a) Consumer goods
 - (b) Public goods
 - (c) Producer goods
 - (d) Essential goods

5. Which of the following is not a benefit of employment generated by businesses?
- (a) People earn money to buy goods and services.
 - (b) People buy more foreign goods.
 - (c) People can save for the future.
 - (d) People can invest in business ventures.
6. When businesses engage in international trade, the country benefits in all of the following ways except
- (a) it gets access to capital equipment for local production.
 - (b) local producers have access to a larger market.
 - (c) it earns foreign exchange to buy goods local producers cannot make.
 - (d) it increases competition for local producers.
7. The tax businesses pay on their profits earned is called
- (a) corporation tax.
 - (b) income tax.
 - (c) purchase tax.
 - (d) value added tax.
8. Businesses fulfil their social responsibility by doing all of the following except
- (a) sponsoring cultural events.
 - (b) exporting goods.
 - (c) granting scholarships.
 - (d) donating to charitable organisations.
9. The personal pleasure one gets from owning his/her own business is referred to as
- (a) extrinsic satisfaction.
 - (b) intrinsic satisfaction.
 - (c) basic satisfaction.
 - (d) direct satisfaction.
10. Which of the following is not a reason why a person may establish a business?
- (a) To benefit financially
 - (b) To generate employment
 - (c) To share profit
 - (d) To become self-employed

/10

Section B

Choose a business that operates in your country. Describe four ways this business contributes to the economic and social development of your country.

/10

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 20 Marks

Session 2: The Internal and External Business Environment

Introduction

You may be aware of the “global economic meltdown” that is presently taking place in the world. News reports bombard us with headlines:

“Global conditions bring negative quarterly growth.”

“Economies reel from global crisis.”

“Testing times and difficult decisions.”

Perhaps in your own country, businesses are reducing the number of people employed. Less money for consumers to spend may even force some businesses to close down.

This present scenario is proof that a business does not operate in isolation. What a business can or cannot do is influenced by the environment in which it operates. The environment is never static; it is always changing. Businesses need to follow trends and be aware of the factors, people and events which make up the environment in which they operate.

This session will introduce you to two aspects of the business environment: the internal and external. You will examine how factors in the environment can influence the activities of a business. Please note that as you continue your study of this course, subsequent units will develop many of these topics in more detail.

Upon completion of this session you will be able to:



Outcomes

Distinguish between the internal and external business environment.

Explain how factors in the environment can affect a business.

Identify strengths, weaknesses, opportunities, and threats (SWOT) of a business.

Internal and External Business Environment

You will recall that a business operates as a system to convert resources into goods and services. You also know that a business operates as part of a wider economic system, which impacts business operations. Thus what a business can do is affected by its own decisions as well as outside influences.

The internal business environment refers to factors and events over which a business has direct control.



Reflection

If you owned a business, what would you be able to control directly?

You are correct if you said that you can control the decisions you make. For example, you can decide what, how and for whom you will produce. Some of the things you can control include the quantity and quality of the product you make, how many people you can hire, and the prices at which you will sell.

Suppose you decide to produce an energy drink. How would the decisions you make be affected by the actions of others? Think of some questions you would have to consider. Are you thinking any of the following?

Will people want to buy this energy drink? Will I get the necessary legal permission to start production? Will people want to work for me? Can I successfully compete with the other businesses making a similar drink?

These questions suggest that you recognise how internal decisions can be affected by what is known as the external business environment.

The external business environment refers to events and factors which are outside the control of a business but which indirectly affect what takes place within it. Events and factors in the external business environment may be political, economic, social and technological. These will be developed later on in this session.

SWOT Analysis of a Business

SWOT is an acronym for the strengths, weaknesses, opportunities and threats of a business. A SWOT analysis involves gathering information relevant to these facets of a business. Strengths and weaknesses are internal factors and opportunities and threats are external factors. A SWOT analysis is important as it clearly outlines the position of the business so it can be guided in its decision making.

Strengths in a business



Discussion

What would you say are your strengths? Is it the fact that you are really good at writing, public speaking, organising events, getting along well with others, or playing a sport? Discuss this with your classmates/tutor.

Now choose your greatest strength. How do you use it? Do you think you can achieve more if you continue to develop your strength?

Like you, strengths of a business are what it is really good at and what it can directly control.

Think of a business you normally visit. What is its main strength? You can continue your discussion on this. Then look at the following definition.

Strengths are internal factors a business possesses which enable it to successfully achieve its objectives.

For example, if a restaurant has an outstanding reputation for excellent quality food and good customer service, people will always return to dine and will encourage their friends to do so. This strength will help the business to achieve its objective of increasing sales and profits.

A business can learn its strengths by identifying all its positive features and which characteristics help in achieving its objectives. These can then be further developed to enhance the performance of the business.



Activity

Make a list of strengths that a business can have. Keep this information to include in a SWOT analysis illustration that will be done later on in the session.

You can check your list with the one provided in the Learners Guide.

Weaknesses in a business

Sometimes a business may not have sufficient money to upgrade its outdated equipment. This will cause disruptions in production, incur additional expenses and cause profits to decline. This is an example of a weakness in a business.

Weaknesses are the negative factors or the internal disadvantages existing within a business which prevent it from achieving its objectives.

It is of crucial importance for a business to do a thorough check of its operations and identify its weaknesses, and then take corrective action to reduce or eliminate them.



Discussion

Recall the business you used in the last discussion. Is this business doing anything that is negatively affecting its operations? Continue this discussion with your classmates/tutor.



Activity

Use all the issues raised in your discussion to make a list of possible weaknesses in a business.

You can check your list with the one provided in the Learners Guide. Again, you will keep this list to use for the SWOT analysis illustration that you will prepare later on.



Note it!

You will note that strengths and weaknesses are things a business has control over, which is why they are internal factors.

What about factors outside the control of a business? These are called opportunities and threats. You will now examine opportunities in a business.

Opportunities in a business

Opportunities are external factors or influences which have the potential to positively impact a business.

For instance, suppose the government makes the use of seatbelts in cars compulsory. The sellers of this product will benefit, as there will be an immediate increase in demand for seatbelts in order for people to comply with this law. This will be an opportunity for businesses to produce and sell more seatbelts and will positively impact their operations and success.



Activity

Make a list of factors in the external environment that can serve as opportunities for the same business you identified in the last activity.

Keep this information to include in a SWOT analysis illustration that will be done later on in the session.

You can check your list with the one provided in the Learners Guide.

Threats in a business

Threats refer to external influences which may adversely affect business operations.

For example, imagine that the government puts a ban on smoking in public places and imposes a high tax on the price of cigarettes. This external factor may reduce the amount of cigarettes purchased and thus negatively affect the sales and profits of businesses producing and selling cigarettes.



Activity

Make a list of factors in the external environment that pose threats to the efficient operation of the same business you identified in the last activity.

Keep this information to include in a SWOT analysis illustration that will be done later on in the session.

You can check your list with the one provided in the Learners Guide.

Opportunities and threats are external factors that force a business to make internal adjustments and decisions to successfully achieve its objectives. To be aware of potential opportunities and threats, a business needs to research the wider community in which it is operating. It must collect information on competitors, existing and potential customers, government policies, technological developments and on anything that can impact its operations. These external factors will be examined in greater detail in the next section of this session.

Before proceeding, gather all the lists you have been making. You will use these lists to create a SWOT analysis for the business.

A SWOT Analysis



Activity

The table below is the format of a SWOT analysis which is generally used to display the current position of strengths, weaknesses, opportunities and threats of a business.

	<u>Strengths</u>	<u>Weaknesses</u>
<u>Internal</u>	A	B
<u>External</u>	C	D
	<u>Opportunities</u>	<u>Threats</u>

Figure 5: A SWOT analysis

Insert the lists you prepared from the last four activities into the table to get a SWOT analysis of the business you examined. The following will guide you:

- In box A insert the internal strengths of the business
- In box B insert the internal weaknesses of the business
- In box C insert the external opportunities available for the business
- In box D insert the external threats to the business



Feedback

Check the table below to see if your points match the suggestions given.

Sample SWOT Analysis for a business

	Strengths	Weaknesses
Internal	<ul style="list-style-type: none"> Ideal location Skilled and experienced workers High quality, well known product Product variety Access to finance 	<ul style="list-style-type: none"> Insufficient capital for expansion Poor customer service Outdated equipment Limited product variety Inexperienced staff
External	<ul style="list-style-type: none"> Efficient infrastructure Technological developments Increasing incomes Government assistance Tax concessions from government 	<ul style="list-style-type: none"> Entry of competitors Increased taxes Government restrictions Declining incomes Rising costs of resources Social factors, eg. if women are allowed to work Lifestyles of people
	Opportunities	Threats

Figure 6



Note it!

A SWOT analysis helps a business to understand its position. It can reveal how a business needs to build on its strengths, grasp its opportunities, eliminate its weaknesses and overpower its threats to achieve its objectives.



Summary

In this session you learnt about factors in the business environment and how they impact the operations of a business. The following points were presented:

- ✓ The internal business environment consists of factors and events over which a business has direct control whereas the external business environment refers to events and factors which are outside the control of a business but which indirectly affect what takes place within it.
- ✓ Strengths exist when internal factors of a business serve as advantages and can be effectively utilised to achieve objectives.
- ✓ Weaknesses are disadvantages that are inherent in the business and prevent it from achieving objectives.
- ✓ Opportunities arise when external influences act as incentives and positively impact the business.
- ✓ Threats refer to external influences which may adversely affect business operations.
- ✓ To guide its decision making, a business can do a SWOT analysis to know its current position and get information on its strengths, weaknesses, opportunities and threats.

Assessment



Assessment

This assessment is a structured question. You are required to write your answers using complete sentences. You should spend at least thirty minutes on this question. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. Choose a business in your community that you are familiar with.
 - (a) Identify two strengths which this business possesses and explain how they can contribute to business success. (5 marks)
 - (b) Indicate two weaknesses you think exist in this business and suggest how each one can be overcome. (5marks)
 - (c) For each of the factors identified below, give examples to show how it can serve as a threat and as an opportunity for the business:
 - i. Political factors (5 marks)
 - ii. Economic factors (5 marks)
 - iii. Social factors (5 marks)
 - iv. Technological factors (5 marks)

Total: 30 marks

Session 3: Stakeholders in Business

Introduction

An announcement has been made that a popular international fast food chain will be setting up a branch in your community. The unemployed youth are happy at the prospect of gaining employment and most people are excited about having a new place to dine out. Some residents are concerned about the increased traffic in the area and local food outlets are worried about the competition. The government is supporting the venture with special tax concessions.

The reactions to the venture described above are further evidence of what you learnt in the previous session: businesses do not operate in isolation. Many people or groups of people may have an interest in a business and are likely to affect or be affected by its operations. They are called stakeholders.

In this session you will learn about the different stakeholders in business. You will recognise their specific interests in a business and understand how they affect and are affected by its operations.

Upon completion of this unit you will be able to:



Outcomes

Define what a stakeholder is.

Identify the interest each stakeholder has in a business.

Describe how each stakeholder affects and is affected by a business.

Stakeholders in Business

Individuals or groups who have an interest in a business and can affect or be affected by its operations are referred to as stakeholders.

The diagram below shows the major stakeholders in a business.

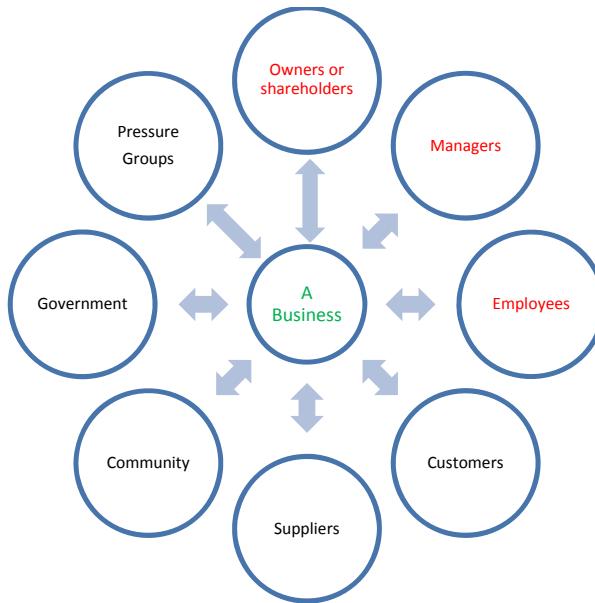


Figure 7: Diagram showing a business and its stakeholders

Stakeholders exist in both the internal and external business environment. The stakeholders in the internal environment are the owners, managers and employees.

Stakeholders in the external environment are customers, suppliers, the community, the government and pressure groups.

You will now examine each of these stakeholders.

Owners

These are the people who have risked their money to invest in the business. Their interest is to get the assurance that the business will be efficiently managed to make a reasonable profit on their investment.

Owners affect the business in two ways:

Firstly, the amount of money they are willing to invest will influence the amount of finance that is available. This will affect the nature and size of the business operations.

Secondly, the extent to which owners are willing to relinquish and delegate authority will affect the decision making powers of appointed managers.

Owners are affected by a business in the following way:

The income they earn depends on how much profit the business makes. This will influence their decision of whether or not to continue with this form of investment.

Managers

Managers have the responsibility of making and implementing plans for the business; their primary interest is to ensure business success and profitability.

Managers affect the business as their skills will influence the efficiency and extent of success that the business will achieve.

Managers are affected by the business as this is their form of employment and their salaries and bonuses depend on what the business can afford to pay.

Employees

These are the people who are paid to carry out certain duties and jobs; their main interest in the business is its role as their employer.



Reflection

Imagine you were an employee in a business.

How will the way you perform your duties affect the business?

How will you be affected by the business?

As an employee, how you perform your duties would have an impact on the productivity, efficiency and hence the success of the business. This is true for all employees in a business, regardless of their job position. Additionally, employees' attitudes and values also influence the interpersonal relationships existing in the business. These relationships can affect whether or not people are comfortable in the work environment and how motivated they are to perform their jobs.

As an employee, you would be affected by the business in terms of how much money you are paid and the amount of hours you are required to work. Generally, the standard of living that employees in a business can enjoy is dependent or affected by the salaries they are paid.

Customers



Reflection

Customers are the people who buy goods and services produced by businesses.

How do your actions as a customer affect businesses? If most people stop buying at a particular business, what do you think will happen?

From your reflection you would realise that customers affect the business as their demand will determine what is produced and offered for sale. Their willingness to buy and the promptness of their payments provide revenue for the business. Success of a business ultimately depends on whether or not customers buy its products.

The main interest that customers have in a business is to get maximum value and satisfaction for the money they spend. Customers are affected by the quality of goods and services the business provides, as this will impact their level of satisfaction and whether or not they will continue to buy there.

Suppliers

Suppliers provide the raw materials and other input needed for business operations. Their interest in a particular business will be in its role as a buyer.

Suppliers affect a business in terms of the extent to which they can provide the right quantity and quality of what is ordered in a timely manner so business operations can proceed efficiently.

Suppliers are affected by the business as the promptness of its payments and frequency of orders will impact their success. This will also influence whether or not they will be willing to continue to be suppliers for that particular business.

Community

People in the community in which a business operates have an interest in a business based on the benefits they can derive from it or if it affects them adversely.

The community affects a business as it is generally from it that the employees and customers will come. If support from the community is lacking, then this will have a negative impact on the success of the business.

The community benefits from a business if employment is provided and when support is given to social, cultural and educational activities. Business actions like improper disposal of waste or contribution to pollution and traffic congestion have a negative impact on the community. Business therefore need to take due care to avoid these negative effects.

Government

A government's interest in a business is based on the benefits the business would bring to society in terms of provision of goods and services, employment and income for the country.

A government affects a business in terms of the rules and laws it implements to monitor or regulate operations. Whether or not a government provides assistance or imposes restrictions can also affect the operations of the business.

A government is affected by businesses as a major source of its revenue comes from the taxes that businesses either pay directly or collect from customers and employees. Tax revenue earned by government is thus related to the number of businesses that exist and the profitability of their operations.

Pressure groups

This refers to persons or organisations with special interests who lobby to get their voices heard. Their aim is generally to create public awareness of how certain activities of a business may be negatively impacting society. Areas of activities that pressure groups tend to focus on include use of animals for testing and making products, damage or danger to people and the natural environment, and exploitation of workers and child labour. Successful campaigning against such activities may cause a business to change its policies to ones that are more beneficial to society.

You may recall various protests that have been launched by groups against the use of animal skins to make fur coats and alligator handbags, the threat to animal life and natural vegetation due to irresponsible dumping of waste and pollution, and products that destroy the ozone layer.

Trade unions can also be considered a pressure group. A trade union represents the interests of workers and bargains on their behalf with employers. Trade union leaders negotiate with employers to get better wages, working conditions and benefits for their members, who are employees in specific industries. You will learn more about this in Unit 7.

The points stated and the issues highlighted in this session may have increased your awareness of the fact that a business is more than just an organisation that produces goods and services. Businesses do not operate in isolation and their activities within the internal and external environment can impact society in either a positive or a negative way. It is therefore essential for businesses to engage in activities that can confer benefits on as many stakeholders as possible.

Session Summary



Summary

In this unit you learned about stakeholders in business.

- ✓ Stakeholders are individuals or groups who have an interest in a business and can affect or be affected by its operations.
- ✓ Stakeholders exist in both the internal and external business environment.
- ✓ The main stakeholders in business include owners or shareholders, managers, employees, customers, suppliers, the community, the government and pressure groups.

Assessment



Assessment

Answer the following questions.

1. Refer to a business you are familiar with. For each of the following stakeholders listed below, identify one way in which they affect the business and one way in which they are affected by the business:

(a) Owners

(b) Employees

(10 marks)

2. Identify two stakeholders which are part of the external business environment. Explain how each stakeholder you identified can have a positive impact on what takes place within a business organisation. (10 marks)

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 20 Marks

Session 4: Legal Guidelines for Business Organisations

Introduction

Would you support a business that is knowingly breaking the laws of your country? Would you buy the “pirate” copy of the latest movie because it is cheaper than the original one? How do you feel about an employer who does not ensure the safety of his/her employees? Should the nearby fast food restaurant be allowed to continue operating even though it is not meeting health standards? These questions hint at legal issues that concern business activities.

Adherence to lawful practices can benefit all stakeholders of a business. When a business is doing what is legally right, people have more confidence in developing relationships with it. All business owners and managers need to take responsibility for promoting and following legal requirements. It is important to have knowledge of the law because, as the old saying states, “ignorance of the law is no excuse for breaking the law”.

In this session you will learn about the legal regulations that govern the establishment and operations of businesses. You will become aware of how these are designed to protect citizens who may function as employers, employees and/or consumers. Emphasis will be placed on laws aimed at ensuring that business operations protect the natural resources and environment of the country.

Upon completion of this session you will be able to:



Outcomes

Appreciate why businesses need to adhere to lawful practices.

Identify legal regulations governing the establishment of businesses.

State legal regulations governing business operations.

Recognise laws relating to consumers.

Describe laws designed to protect employees.

Regulations Governing Establishment of Businesses

All businesses operating in an economy are required to do so within the limits of the law simply because it is the right and legal thing to do. When a decision is made to establish a business, it must be to provide a good or service that is accepted as lawful in the country. Additionally, regulations governing areas, such as business registration, licences, and the location and construction of buildings, need to be followed. Let us now examine these regulations.

Business registration

When a decision is made to start a business, owners are required to register it with the Registrar of Companies. This is the institution that oversees and provides advice on business registration. It has records of all businesses operating in a country. The registrar has the power to approve or reject the name chosen for a business. Usually a name will be rejected if it is too similar to one of an existing business, or if it hints at anything that can be offensive to any person(s), or religious or political organisations. Depending on the form of business organisation chosen, there are specific guidelines to follow in order to obtain the necessary certification from the Registrar of Companies before business activities can commence. You will learn more about this in Unit 3.

Legal permission to operate

Some businesses are required to get a licence, which gives legal permission to operate. It is therefore essential for businesses to obtain this from the relevant authorities. Let us examine a few examples of businesses in Trinidad and Tobago which require licences, and identify the authorities that provide them:

Type of business	Licence required	Agency to grant licence
Food production, distribution and sale	Food badge or health certification	Ministry of Health
Sale of alcoholic beverages	Licence to sell spirituous liquors	Magistrates Court

Type of business	Licence required	Agency to grant licence
Transport Service providers, e.g. taxi cabs	Driving permits	Ministry of Transport
Sale of medical drugs, pesticides, chemicals and toxic products	Licence to sell these products	Food and drug division of the Ministry of Health
Fete or party promoters, radio stations; also businesses that play music on their premises for customers, e.g. banks, restaurants, beauty shops	Permission to play music that has copyrights	Ministry of Legal Affairs-Intellectual Property Department Copyright Organisation of Trinidad and Tobago COTT Trinidad and Tobago Copyright Collection Organisation

Figure 8

The main purpose of these licences is to ensure that businesses comply with the specified terms and conditions outlined in the interest of all stakeholders.



Activity

For this activity, you need to use the scrapbook which you started during your study of Unit 1. Identify at least three of the businesses which require licences to operate. Write under the picture of the business, the type of licence that is required for the business to legally operate.

You can check the accuracy of what you have written in the scrapbook by referring to the table in Figure 8 above.

Location of businesses

All businesses need to conform to the land use and zoning laws of a country. These regulations specify areas where particular types of business can be located. Usually the Town and Country Planning Division monitors the areas of land designated for certain purposes, for example, agriculture, industrial production, commercial businesses, residential homes, natural vegetation and recreation, to name a few. Thus, for instance, a person cannot set up an industrial production business in a residential area.

Some businesses may pose a threat to people and the environment because of the pollution they cause and the dangerous nature of their production. Examples of large scale industrial production include cement plants, steel and aluminium smelters, oil refineries, and plants involved in producing dangerous and toxic chemicals. The Environmental Management Authority has to approve the site for businesses such as these to ensure that certain standards are met and maintained. The main purpose of this is to minimise and/or prevent damage to the environment and people.



Discussion

Recently in Trinidad people have been publicly protesting about the government's plans to build an aluminium smelter plant in La Brea. Find out more about this and discuss with your class whether or not you think these protests are justified.

Construction of buildings

Businesses need to follow regulations for the construction of buildings. The factory layout and the work environment of all businesses have to meet safety and health standards and be approved by the relevant authorities. These regulatory bodies include the Factory Inspectorate, Lands and Buildings Inspector, the Health Inspector and the Fire Department. Let us examine a few of the areas which are monitored.

The construction of buildings on the factory site to ensure:

- ✓ Safety for all stakeholders
- ✓ Proper storage facilities for dangerous substances
- ✓ Enclosure of areas with power and electrical generators
- ✓ Well displayed emergency exits and muster points for gathering in cases of emergencies
- ✓ Adequate provisions for disposal of waste
- ✓ Clean, well ventilated workstations

For businesses that produce and sell food items there are even more stringent health standards to ensure that everything is done under approved hygienic conditions.

Regulations Governing Business Operations

After a business gets the relevant approvals and is constructed and established, there are additional regulations for monitoring the following areas of its operations:

The buying and selling of goods and services

Many regulations exist to govern the buying and selling of goods and services. These are generally aimed at protecting the rights of both sellers and buyers. Some of these include:

- ✓ Contracts, which will be explored in Unit 8
- ✓ Credit sales and hire purchase agreements, which will be explained in Unit 13
- ✓ Selling and marketing online
- ✓ Accounting procedures and submission of accounts for auditing
- ✓ Laws to regulate specific industries such as banks, telecommunication providers, food and dangerous drugs

Payment and collection of taxes

Businesses need to register with the relevant tax authorities in their country, such as the Board of Inland Revenue in Trinidad and Tobago. Taxation is the major source of revenue for governments of most countries (you will learn more about this in Unit 22). Businesses are required to pay certain taxes, for example, corporation tax, import duties, and excise duties. Additionally, businesses have the legal authority to collect tax revenue on behalf of the government. Some ways in which this is done are income tax deducted from the salaries of employees and purchase taxes, like Value Added Tax (VAT), included in prices. With this authority comes the legal responsibility for businesses to remit the tax revenue they collect to the government.

Import and export of goods and services

Businesses which engage in international trade have to follow the regulations governing import and export of goods (you will learn more about this in Unit 26). Sometimes special import licences are required to grant permission to bring certain goods into the country; some imports may be subjected to tariffs while others may qualify for tax exemptions. Businesses must be able to provide the supporting documented information. They can get advice on these regulations from the Ministry of Trade as well as The Customs and Excise Division.

Regulations Governing Employees

Fair treatment of workers is important for getting jobs done. All businesses need to adhere to the laws and regulations governing employment. An analysis of all these is beyond the scope of this course but a few will be mentioned.

Terms of employment

Most countries have laws with respect to issues relevant to employment. These may include equality of opportunity, minimum wage, hours of work, and overtime payments. For termination of employment, there are stipulations regarding pensions, and retrenchment and severance benefits.

Working conditions

Working conditions, with emphasis on health and safety standards, is another area of high priority for government monitoring. It is essential for all business owners and/or managers to familiarise themselves with the Occupational Health and Safety Act (OSHA) and ensure that measures are put in place to observe them. This, as the name suggests, is designed to ensure that safety measures are put in place to prevent workers and all other stakeholders from injury or hazardous situations that may exist in the premises or operations of the business.

Welfare of employees

For the welfare of employees, there is the compulsory registration of all with the National Insurance Scheme (NIS). This is designed to provide monetary compensation for people who may suffer loss of earnings due to illness and/or injury. Employers are required to register all employees with the National Insurance Board and to ensure that contributions are made on their behalf so that they can be entitled to benefits when necessary. The contributions consist of payments made by both the employer and the employee. You will learn more about this in Unit 18.

Industrial relations

Regulations also govern industrial relations and give workers the right to trade union representation. The main aim of a trade union is to collectively bargain with employers on behalf of workers. Special areas of emphasis when bargaining include demands for better wages, working conditions, benefits, and terms and conditions of employment.

Sometimes an individual business may design its own employment standards, regulations and benefits but these must conform to what is stipulated by the laws of the country.

Laws Relating to Consumers

Consumers are generally at the mercy of businesses and can be easy victims of exploitation. To prevent this, many governments delegate responsibility to a Consumer Affairs Department or Ministry to monitor business operations in the interest of consumers. Some of the main aims of laws and regulations relating to consumers include consumer protection; consumer education; enforcement of laws, and redress for complaints. These will be explained in Unit 14. However, you will now be given a preview of what these regulations entail.

Consumer protection

Consumer protection regulations govern areas such as unfair trading practices, misleading advertising, contracts, terms and conditions for credit purchases, guarantees for products and dual pricing.

Consumer education

The objective of consumer education is to provide people with advice and information about their rights and responsibilities so that they can make wiser choices as consumers and not be exploited by businesses.

Enforcement of laws

Enforcement of laws focuses on making sure that businesses adhere to the laws and regulations. Special officers are employed to monitor and check businesses for compliance with laws to ensure protection of the consumer.

Redress for consumers

Redress for consumers refers to actions people can have recourse to if they have complaints against businesses. Some of the organisations which address issues on behalf of consumers include the Ministry of Consumer Affairs, the Ombudsman and consumer organisations such as the Housewives Association of Trinidad and Tobago (HATT).



Discussion

Have you ever been unfairly treated by a business? Share this experience and state which regulation you think the business violated. Discuss how this situation could have been dealt with differently.

The laws and regulations governing businesses are designed to ensure their welfare and protect all stakeholders. Obeying the law is our responsibility and it is the right thing to do. However, many times the benefit of these regulations are not realised because of deliberate violations by some individuals or organisations. It is therefore important that the authorities put mechanisms in place to detect violations and take corrective action, or to impose severe penalties to serve as a deterrent to law breaking. However, in the final analysis it is really up to each of us to do the ethical thing as individuals and collectively this will result in benefits for the entire country.

As you proceed with your study of this course, you will be provided with more detailed information about many of the issues raised in this session.

Session Summary



Summary

In this unit you learned the legal guidelines for business organisations. The main areas of focus were:

- Regulations governing business establishment, which include business registration, licences, land use, zoning, and building construction and layout.
- Regulations for business operations, such as the buying and selling of products, payment and collection of taxes and international trade transactions.
- Regulations governing employees to ensure fair treatment, health and safety standards and provision of social security.
- Laws relating to consumers to ensure protection, education, enforcement of laws and redress for complaints.

Assessment



Assessment

Fill in the blanks in the sentences below by using the following words.

Please note that each term in the list can be only used once.

consumer protection, import, Board of Inland Revenue, Trade Union, licence, redress, Registrar of Companies, National Insurance, Environmental Management Authority, Occupational Health and Safety Act

1. The institution that has responsibility for business registration is called
2. Obtaining the relevant gives a business the legal permission to operate.
3. The institution that has to give approval for the site of businesses that can pose a threat to the environment is known as the
4. The is the state controlled department that all businesses need to register with to have legal authority to collect tax revenue on behalf of the government.
5. Special licences are granted to businesses that wish to import goods that were bought in other countries.
6. Regulations governing measures that employers must put in place to prevent employees from dangerous or hazardous situations in the workplace are outlined in the
.....

7. The compulsory Scheme is designed to provide monetary compensation for employees who may lose earnings from being unable to work due to sickness or injury.

8. The organisation that represents workers and bargains with employers on their behalf is called a

9. Unfair trading practices and misleading advertisements are two of the areas governed by legislation.

10. refers to the opportunity that consumers have to take action for complaints they may have against businesses.

Total: 10 marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Unit Summary



Summary

In this unit you learned about the following:

- The role of businesses and why they are established by both private persons and the government.
- The factors in the internal and external business environment that impact a business.
- The SWOT (Strengths, Weaknesses, Opportunities, Threats) and PEST (Political, Economic, Social, Technology) analyses business should conduct.
- Stakeholders that have an interest in a business and are in a position to affect and be affected by its operations.
- The legal regulations that govern the establishment and operations of businesses.
- How rules and regulations are designed to protect citizens who may function as employers, employees and/or consumers

The following diagram is an illustration which can serve as an overview of the main stakeholders, influences and factors which exist in the internal and external business environment.

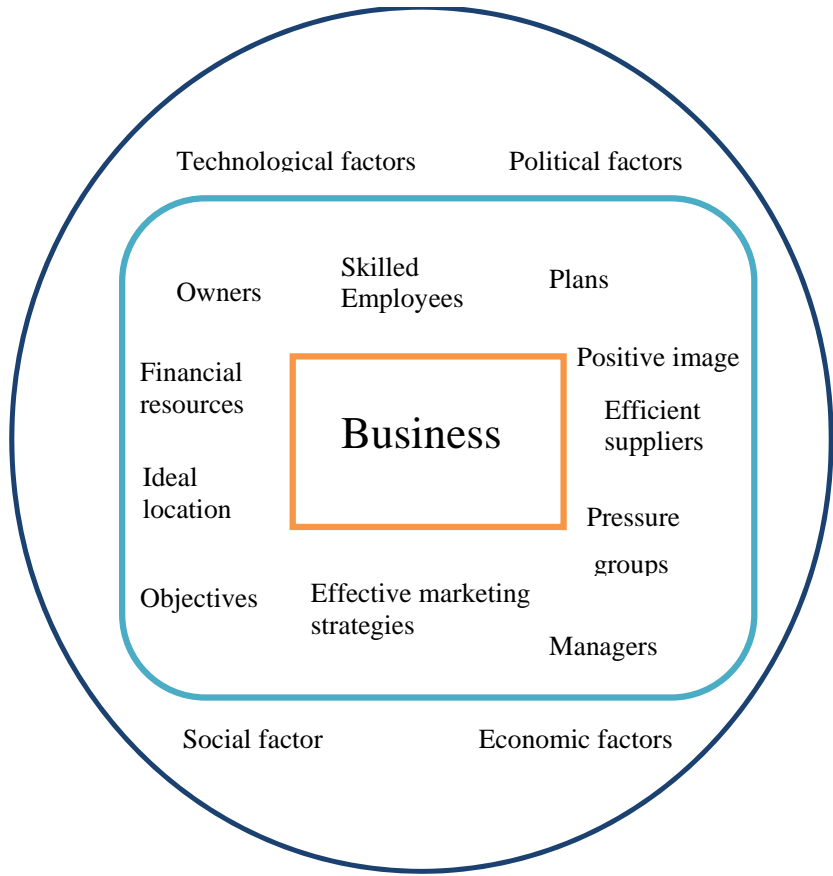


Figure 9

Assignment



Assignment

Now that you have completed your study of the unit on the business environment you can apply the knowledge acquired and attempt the following assignment. Read the stimulus material presented in the scenario and write clear precise answers to the questions which follow. You should spend forty-five minutes on this assignment. When you are finished, submit the assignment to your tutor for evaluation. Submit the session assessments that you have completed and self-marked if your tutor has asked for these.

Now read the scenario below and answer the questions that follow.

Scenario:

A group of people wish to go into business to set up a shopping centre that will provide rental space for a wide range of retail outlets. This decision was made because they recognised that presently there is high consumer demand because of rising income levels and standards of living in their community. They plan to attract boutiques with the latest designer clothes, footwear and accessories, electronic stores offering up-to-date devices like computers, iPods, cell-phones, video game systems, a branch of an international supermarket, popular fast food outlets like Kentucky Fried Chicken, TGIF, McDonald's, and entertainment centres such as cinemas and sports clubs.

Research revealed that the town centre does not have enough space to accommodate this venture. However, on the outskirts of the town there is a large available expanse of land that has adequate supplies of water and power, as well as a good transport and communication network. A decision was therefore made to buy this land and set up an out-of-town shopping centre. Applications have been made to the relevant authorities for the required permission to begin construction. Residents in the nearby neighbourhoods have voiced their support and are looking forward to the opening of the shopping centre for both employment and a comfortable, hassle free area to shop and to have access to entertainment facilities.

Questions:

1. State three reasons why you think the group of persons decided to establish this business venture. (6 marks)
2. Describe two benefits that the existence of this business will have on the country. (4 marks)
3. Suggest one way in which each of the following factors in the external environment can have a positive impact on the shopping centre when it is established:
 - i. Social factors
 - ii. Economic factors
 - iii. Political factors (6 marks)
4. State one possible threat to this business venture and suggest an action that can be taken to minimise its negative impact. (4 marks)
5. Discuss two internal strengths that retail outlets in the shopping centre will possess and show how they can contribute to their profitability and success. (10 marks)

Total: 30 marks

Unit 3: Legal Forms of Business Organisations

Introduction

Have you ever wondered why some businesses have “one person” owners, others have several, and some even have thousands of owners? The decision of how many owners a business should have is an important consideration and a major factor in determining the choice of legal form that a business organisation establishes.

Recall from Unit 1 that in a mixed economy goods and services are supplied by both the private sector and public sector. In the private sector, the main legal forms of businesses that exist in most countries are sole traders, partnerships, corporations, and co-operatives. In the public sector, organisations owned or controlled by the government are usually government departments and ministries, local or municipal authorities and public corporations.

The sessions in this unit will give you the opportunity to identify the factors that influence which legal form of business organisation to choose in the private sector, examine the procedures for setting up the different forms of businesses and look at the essential characteristics of each one. You will then be able to compare the advantages and disadvantages of each form of business and appreciate which one is most suitable for particular situations. You will also be able to identify the characteristics generally inherent in public sector organisations which are owned by the government of countries.

Upon completion of this unit you will be able to:



Outcomes

- *Identify* factors that influence the choice of legal form of business.
- *Explain* the characteristics of legal forms of businesses.
- *Compare* the advantages and disadvantages of the different forms of businesses.
- *Suggest* an appropriate form of business for different situations.
- *Describe* public sector organisations that provide goods and services for citizens.

The sessions in this unit are:

Session 1: Sole Trader and Partnership

Session 2: Corporations

Session 3: Franchise businesses, Multinational corporations and Conglomerates

Session 4: Co-operatives

Session 5: Public Sector Organisations

Time frame: Twenty hours (20 hours)

Session 1: Sole Trader and Partnership

Introduction

John used his personal savings to pursue his dream and establish a business doing customised printing of T-shirts. His work has become so popular and he receives so many orders for T-shirts that he needs to expand business operations. However, he does not have the extra money to do so. John is weighing the benefits he enjoys as sole owner and manager with those he may enjoy if he allows his two friends to join him and become partners in the business. What do you think John should do? What would you do in a similar situation?

In this session you will learn about choices that can guide a person in choosing a legal form of business organisation. You will be able to describe the essential characteristics of the sole trader and partnership forms of business organisations. With this knowledge you will discover the advantages of each form and be able to give recommendations for overcoming any inherent disadvantages.

Upon completion of this session you will be able to:



Outcomes

Identify the factors that influence the choice of legal form of business.

Describe the characteristics of a sole trader.

Discuss the advantages and disadvantages of a sole trader.

Distinguish between a general and limited partnership.

Explain the advantages a partnership has over a sole trader.

Recommend a form of business that can overcome the disadvantages of the sole trader and partnership form of business.



Terminology

Legal:

Doing what is within the laws of a country or officially permitted.

Incorporated business:

One that has a separate legal identity apart from its owners.

Unincorporated business or corporations:	One where the owners do not have a separate identity from the business and are held personally liable for all its obligations.
Finance:	Money or start-up capital that is required to set up and operate a business enterprise, for example, premises, stocks, and equipment.
Liability:	The extent to which the owners of a business will be held responsible for the debts incurred.
Tax:	A compulsory payment levied by the government on income and expenditure for which no direct benefits are received.
Collateral:	Items used as security to get a loan.

Choice of Legal Form of Business

In making a decision to establish a business, an important consideration is choosing the legal form of organisation that will be most beneficial. The possible forms of business organisations in the private sector are sole trader, general or limited partnerships, private or public corporations and co-operatives. The main differences among these forms include factors such as number of owners, legal formalities required for formation, sources of finance, type of liability, management and control, sharing of profits and losses and tax issues. It is important to understand these factors as they can influence the choice of legal form of business a person or group of persons may wish to establish.

A brief explanation of the factors identified above will now be presented. Please note that as you proceed with your study of this unit, each of these factors will be further explained as they are applied to the different forms of businesses.

Nature of ownership

This deals with how many persons wish to be owners of the business and the procedure for change or transfer of ownership.

Why do you think this should be a significant consideration?

Ownership has important implications for many aspects of business operations, such as the amount of finance that will be available, decision making and control, the sharing of profits and losses and the continuity of existence of the business.

Legal procedures for formation

Different legal procedures are required for the formation of different forms of businesses. You will recall that you learnt about this in Unit 2. Legal formalities, such as registration of the business with the Registrar of Companies and acquisition of relevant licenses and permits, may be required prior to beginning operations. The complexity and cost of the legal formation process usually increases with the progression from sole trader to the other forms of businesses.

Businesses can be incorporated or unincorporated.

Incorporation is the legal procedure which gives a business a legal identity or personality that is separate from that of its owners. As a result, owners cannot be held responsible for commitments an incorporated business makes. Instead, the corporation accepts responsibility for these commitments, obligations and debts.

In an unincorporated business, owners and the business are not viewed as separate. As a result owners are held personally responsible for business commitments, obligations and debts.

Source of finance

The ability to raise the finances or start-up capital necessary to begin a business is largely dependent on the nature of the business, the risk involved and the number of investors. This, in turn, will influence the form of business chosen. Generally businesses that require larger amounts of money to be established tend to have more owners than those which are less costly to establish, as more investors may be needed to make financial contributions. This also depends on the extent of liability and risk that the investors are willing to undertake. This point is further developed in the explanation of the next factor that will now be addressed.

Type of liability

Liability refers to the extent of the debts of a business that owners will be held responsible for. Liability can be unlimited or limited depending on the legal form of business that is established.

With unlimited liability, the owners of a business can be held personally responsible for all the debts of a business. This means that if the business owes more money than what the owner has invested in it, then personal assets can also be used to settle the debts.

With limited liability, owners can only be held responsible for the amount

of money invested in the business. Thus creditors can only claim business assets or the money invested in the business to settle debts, not the personal assets of the owners or investors.

Management and control

Basically, management refers to the person or persons who are responsible for decision making and ensuring that the plans of a business are implemented successfully.

In some forms of business, the owner(s) can perform management functions and have total control over all decision making. This is more suitable for businesses where operations are small and simple and there are one or a few owners.

In forms of businesses that may have larger numbers of owners, there tends to be separation between owners and management. Owners may delegate management responsibilities to a few owners and/or to hired professional persons. However, the element of control is still retained by owners through their input in the selection process of the management team. This strategy is generally used for bigger and more complex business operations where the greater number of owners makes it impossible for all of them to manage the business, even if they possess the skills.

Sharing of profits and losses

In the last unit you saw that one of the main reasons for establishing a private business is to make a profit. The extent to which owners are willing to share profits and bear losses will influence the form of business chosen; indeed, the form will determine how many owners there are for the profits and losses to be shared among. Please note that this is a relative situation and the actual amount of profits earned or losses borne will depend on the success of the business, and not necessarily on its legal form of organisation.

Tax issues

Different forms of businesses may be governed by certain distinctive tax regulations. In Unit 2 you learnt about the general tax requirements that all businesses must adhere to. However, in most countries the income earned by different forms of businesses may be viewed differently for tax purposes.

Generally the profits earned by owners of unincorporated businesses are only taxed as personal income.

Incorporated businesses are required to declare profits earned by the business as a separate entity and pay corporation taxes, then when owners receive their share of the profit they have to declare this as personal income and pay income tax.

Personal income tax and corporation tax usually have different rates in different countries. In some countries the government may use certain tax incentives to encourage the formation of certain types of businesses which, in turn, may influence the legal form of business chosen.



Activity

Do the following activity as a simulation with your classmates. A friend just informed you of his desire to set up a business. Advise him on the general factors he needs to consider before deciding on choice of a form of business.

Refer to the Learners Guide for feedback on this activity or discuss the topic with your tutor.

In the remainder of this session, you will examine the sole trader and partnership forms of business organisation using the factors that were discussed in the last section

Sole Trader

Nature of ownership

A sole trader, which is also called a sole proprietorship, is a form of business that is owned by one person. There is no difference between the owner and the business, as both are considered to be one. This makes this form of business an unincorporated one. Thus the owner is personally responsible for all the commitments of the business.

The death of the owner or bankruptcy legally brings the sole trader form of business to an end. However, it is possible to ensure continuity of existence in the case of death if the owner passes the right of ownership to a specified person in his last will and testament.

Procedure for formation

A sole trader is a simple form of business and is very easy to set up as there are little or no formalities or registration expenses. The owner can simply inform the Registrar of Companies of the establishment of the business, but this is not normally required for small, informal businesses. However, depending on the nature of the activity to be pursued, the owner will need to obtain the relevant licence or permission to operate. You

learnt about these in the last unit.



Reflection

Can you recall some types of business activities that need a licence in order to operate?

You may review these now from Unit 2 to see if you answered correctly.

Although not required by law, a person who wants to set up a business should prepare a **business plan** to clearly map out the aims of the business and how they will be pursued. You will learn how to do this in Units 10, 20 and 30 of this course.

Effective planning can increase the success rate of a business. Many owners of sole trader forms of business may not make a formal business plan, but informally they may have a plan in their heads. For example, a young mother who needs money and decides to sell clothes she brought from abroad to her friends, from a suitcase, is an example of a sole trader. One day she may be able to formally plan this activity and establish a boutique. Or a young man who repairs computers for his neighbours for a small fee may have a plan to one day open a business to service, repair and even sell computers.

Source of finance

The owner usually uses personal savings or any money that can be borrowed to start the sole trader form of business. Possible sources of loans include friends and/or family, especially if one does not have sufficient personal assets to use as security for a loan from a financial institution. The sole trader, who has collateral or assets to use as security, may be able to get loans from institutions, such as banks or credit unions. In many countries, a sole trader may get special funding from the government as this may be granted in an attempt to encourage their development.

Type of liability

The sole trader form of business organisation has unlimited liability. This means that the owner is personally and legally responsible for all the debts that the business incurs. The owner is thus liable to lose not only the business assets but also personal ones in the event that the business is in debt or is being sued. For example, personal assets, such as savings in the bank, a house, or a car, may be forfeited to repay business debts.

Management and control

In a sole trader business, the owner is usually the manager. This person has authority and responsibility for all the decisions in the business and can make all the plans. There is no need to consult with anyone to get approval for strategies to be implemented. The owner acquires the resources needed and has total control over all business operations. If the organisation is too large for the owner to operate alone, family members may assist or workers will be employed.

Sharing of profits and losses

All profits earned belong to the single owner in a sole trader business. However, if losses are incurred, the owner, as the sole risk taker of the business venture, will have to personally bear all losses alone.

Tax issues

The sole trader's business is not taxed as a separate entity. Instead, any profits earned or losses suffered by the owner are declared as personal income and will be taxed accordingly. Some sole traders, if registered with the revenue authorities, may have the authority for collection of value added tax (VAT) or purchase tax from buyers. With this authority, the owner has the responsibility of remitting the tax revenue collected to the relevant government department.



Activity

Identify two businesses in your community which operate as sole traders. Conduct an informal interview with the owners of the businesses to find out what benefits they enjoy and what challenges they face. Discuss with them how the challenges and any problems experienced can be resolved. You are required to share your findings with your colleagues.

Advantages and disadvantages of the sole trader

You can now examine the two tables below to see how the sole trader form of business has both advantages and disadvantages.

Advantages of the Sole Trader	
1	Easy procedure for formation: The sole trader business is very easy to set up as there are little or no legal formalities or costs involved. This makes it a very popular form of business and explains why it is so widely used by many people in most countries today.
2	Flexibility in management: The sole owner of the business, who is usually the manager, can make all the decisions. This saves time and gives greater flexibility in making changes. There is no need to wait on approval from other persons before decisions can be made. The owner is the boss and can work at whatever pace desired.
3	Enjoys all profits: The owner of the sole trader business enjoys all the profit earned. This is the reward for investing money and undertaking the risk involved in the enterprise.
4	Gets incentives from government: The sole trader form of business usually receives incentives from governments. These include lower tax rates, financial assistance and advice. These incentives promote the development of this form of business and are valuable in enabling them to successfully continue operations.
5	Close interpersonal relationships: As the sole trader business is usually small, the owner tends to have greater personal contact with his/her customers. This personalised service enables the business to better meet the needs of customers and contributes to its success.

Disadvantages of the Sole Trader	
1	Unlimited liability: As the only risk bearer, if the business is unsuccessful, the owner has to bear all losses alone. Additionally, the sole trader form of business has unlimited liability. Thus the owner faces personal liability and is likely to lose personal possessions in the event that debts incurred by the business cannot be covered with its existing assets.

Disadvantages of the Sole Trader	
2	Limited finance: As the owner is the only contributor of finance, capital is limited to personal savings and loans. This may result in difficulties in achieving growth, such as expanding or diversifying business operations.
3	Limited ideas: As the only decision maker, the owner/manager has full responsibility for the business. There is no one to consult and this may limit ideas and choices. However, the sole trader can always seek advice from other people, and even experts, to ensure more effective decision making.
4	Limited life or existence of the business: The death of the owner legally brings the sole trader business to an end. As mentioned previously, this disadvantage can be avoided if the business is willed to someone before the owner dies. However, sometimes family members may find it difficult to maintain continuity of business operations, especially if they were not actively involved in it and do not know the “trade secrets” that the owner may have mastered.

You now understand why the sole trader is one of the most popular forms of businesses. It is easy to establish and the owner has flexibility in decision making and managing time. The owner enjoys all profit earned, incentives from the government, as well as the benefits of having personal contact with customers. In reality, making one’s own business a success requires a lot of time, personal dedication and commitment, perhaps even more than when one is an employee. As the sole trader business grows, it may become difficult for one person to manage and the inherent disadvantages of unlimited liability and limited finance and ideas may encourage the owner to change the legal form of the business. Very often, a partnership may be formed.

Let us now examine the characteristics of the partnership form of business.

Partnership

Nature of ownership

A partnership is an association of two to a maximum of twenty persons who agree to set up a business in order to make a profit. The people are co-owners of the business and are called partners.

There are two types of partnerships: general and limited and the main differences between them are presented in the table below.

	General Partnership	Limited Partnership
Type of partners	All owners are general or “active” partners.	At least one owner is a limited or “silent” partner and the others are general partners.
Type of liability	All general partners have unlimited liability and are personally responsible for the debts and obligations of the business.	The limited partner has limited liability and can lose only what he has invested in the business but the general partners have unlimited liability.
Management and control	General partners manage the business. Any general partner acting on behalf of the business can “bind” all partners. This means that all partners can be held legally responsible for the action/ decision or obligation/ debt incurred by any one partner.	Only the general partners manage the business. Limited partners do not participate in running the business.
Transfer of ownership by partners	If a general partner dies or is no longer interested in continuing with the business arrangement, the partnership has to be dissolved. This means it has to be brought to an end and a new one will have to be formed.	There are no restrictions if the limited partner wishes to sell ownership or interest in the partnership. This can be done once someone is willing to buy this share of the business. The limited partner can assign shares for someone to receive in the event of death.

Procedure for formation

A partnership is formed by a mutual agreement between the persons who decide to be partners in the business arrangement. Like the sole trader form of business, a partnership is relatively easy and inexpensive to establish. All that is formally needed is basic registration with the Registrar of Companies and the acquisition of the relevant licence.

It is recommended that a legal agreement called a Deed of Partnership or Partnership Agreement be used in the formation of this business. This can be oral or written and will contain information on key issues that can impact the organisation.

A Deed of Partnership includes the following:

- a) The name of the business and its starting date
- b) The capital contributed by each partner
- c) How profits and losses will be shared
- d) The role, duties and authority of each partner
- e) Details on voting rights and the procedure for making decisions
- f) Procedures for dealing with conflicts
- g) Guidelines for admission of new partners and departure of existing ones
- h) Arrangements for financial matters such as borrowing powers and limits
- i) How the partnership can be brought to an end or dissolved.

Source of finance

The main source of finance in a partnership is from the contributions invested by all the partners. This is also called start-up or equity capital and can take the form of cash or property. The business also has borrowing powers as outlined in its Partnership Agreement which will allow loans to provide additional financing. As determined by the Partnership Agreement, retained or "ploughed back" profits can provide the business with another source of finance.

Type of liability

In a general partnership, all the general or active partners have unlimited liability and are personally liable for the debts and obligations of the business. In a limited partnership, the silent or limited partners enjoy limited liability but at least one general partner has unlimited liability.

Management and control

A partnership is managed by the general partners. Their roles, responsibilities and authority will be specified in the Partnership Agreement. However, as mentioned previously, in a limited partnership, the limited partner who enjoys limited liability does not participate in management of the business.

Sharing of profits and losses

All partners share in the profits and losses of the business as outlined in the Partnership Agreement. Sometimes provision is made to use a stated portion of the profit as retained earnings to provide additional finance for business operations.

Tax issues

Like the sole trader, a partnership business is not taxed as a separate entity. Instead, any income earned by the partners is declared as personal income and is taxed at rates which will be slightly lower than corporation rates.

From your study of both the sole trader and partnership, do you think the old adage “two heads are better than one” is applicable? Attempt the following activity to discover the benefits a partnership may have over a sole trader form of business.



Activity

Imagine that you operate a business as a sole trader and a friend advises you to convert to a partnership. Make a list of the advantages you think you will gain if you make this change.

Check your response to the above activity with the advantages of a partnership form of business outlined below.

Advantages of a Partnership form of business	
1	Easy procedure for formation: Like a sole trader, a partnership is relatively easy and cheap to establish, with little or no legal formalities.
2	Greater access to finance: Unlike a sole trader, a partnership has additional sources of finance from the combined equity or capital contributions made by the partners.
3	Specialisation in management: Since many partners are involved in operating the business, tasks can be divided and assigned to those with relevant skills and expertise. This sharing of responsibilities and specialisation will reduce the work burden per person and also positively impact the efficiency of the business. Additionally, more ideas can be generated from among the many partners compared with the sole trader, who manages the business alone.
4	Sharing of losses: The losses incurred in a partnership are shared among the partners as specified in the Partnership Agreement. This is an advantage over the sole trader business where the single owner bears the burden of losses alone.
5	Greater continuity of life or existence of the business: The death or withdrawal of a general partner will cause a partnership to be dissolved or brought to an end. This is similar to a sole trader. However, this can be avoided and continuity of the business can be ensured by including a relevant statement in the Partnership Agreement. Additionally, the partners who remain will have the necessary experience and expertise to enable successful continuation of the business.

Now you understand how the advantages of a partnership can solve some of the disadvantages of the sole trader form of business. The question that you are probably asking is “Are there any disadvantages of operating a business as a partnership?”

The choice of a partnership as a popular form of business is limited by the following disadvantages, which are presented below.

#	Disadvantages of a Partnership form of business
1	Unlimited liability for general partners: Like a sole trader, the general partners in a partnership have unlimited liability. This acts as a deterrent to investment, as many are unwilling to accept personal liability for the debts of a business.
2	Access to capital is still limited: Even though the partnership has the possibility of accessing capital contributions from as many as twenty partners, the equity of the business is still restricted to this maximum amount. This limit is also coupled with the fact that the general partners have unlimited liability so they may not be willing to risk as much money as if they were able to enjoy limited liability.
3	Possibility of conflicts: Inevitably, conflicts can arise once many different people with varying personalities and objectives come together. However, the negative effects of conflicts can be avoided if measures are taken at the beginning to include procedures for dealing with conflict in the Partnership Agreement.

You will appreciate the fact that both the sole trader and partnership forms of business have their unique advantages and disadvantages. As you have seen, the partnership can overcome some of the problems faced by the sole trader, such as limited capital, continuity of existence and unlimited liability. However, the partnership still faces these problems even though it is to a lesser extent than the sole trader, plus the additional risk of possible conflicts. How can these be overcome? Basically, the establishment of incorporated businesses or corporations can successfully address all these problems. In the next session you will get the opportunity to learn about incorporated businesses, such as private and public limited liability companies, and see the advantages they have over the sole trader and partnership forms of business organisations.

Session Summary



Summary

In this unit you learned about factors that influence the choice of a legal form of business and the main characteristics of the sole trader and partnership forms of businesses.

Choice of a legal form of business is influenced by:

- ✓ The number of owners desired
- ✓ The complexity of the procedure for formation
- ✓ The available sources of finance
- ✓ The type of liability owners wish to accept
- ✓ The nature of management and amount of control desired
- ✓ The procedure for the sharing of profits and losses
- ✓ The tax issues relevant to the business

The main characteristics of the sole trader form of business are:

- ✓ It is owned by one person, who is usually the manager and the sole contributor of finance, and the only one to enjoy all profit earned.
- ✓ It is very easy to establish, with only the relevant licence being required in some cases.
- ✓ The owner has unlimited liability and in addition to bearing all losses alone, can lose personal possessions if the business fails and debts have to be settled.

The main characteristics of the partnership form of business are:

- ✓ The partnership form of business can be general or limited.
- ✓ Both types of partnerships can have two to twenty partners who voluntarily agree to join the venture.
- ✓ All partners in the general partnership have unlimited liability but only one partner in a limited partnership needs to have unlimited liability.
- ✓ A Deed of Partnership or Partnership Agreement contains all rules and regulations governing the operations of a partnership, as agreed by all partners.
- ✓ A partnership is usually managed by the general partners.

- ✓ Profits earned in a partnership are usually shared among partners in proportion to their financial contributions or as specified in the Partnership Agreement

The partnership form of business enjoys the following advantages over the sole trader:

- ✓ Ability to raise more finance as there are more owners to contribute start-up capital
- ✓ Shared decision making and specialisation among the owners who participate in the management of the business
- ✓ Greater opportunities for continuity of business existence
- ✓ Limited partners are able to enjoy limited liability

Despite its advantages over the sole trader, the partnership faces the following disadvantages:

- ✓ Possibility of conflicts among partners when decisions have to be made
- ✓ Finance is limited to contributions from only a maximum of twenty partners
- ✓ Some partners still have to accept unlimited liability

Assessment



Assessment

This assessment consists of two sections.

Section A is made up of ten sentences. Fill in the blank spaces from a list of words given. You should spend five minutes on this section.

Section B consists of a structured question requiring you to write a few sentences for each of the three parts. You should spend fifteen minutes on this question.

Section A:

Complete each of the ten sentences below by using the most appropriate word from the following list of words:

partnership agreement, general, liability, incorporation, incentives, continuity, limited liability, finance, unlimited liability, profits, Registrar of Companies, conflicts

1. is the legal procedure which gives a business a personality or legal identity separate from its owners.
2. The extent of the debts of a business that owners will be held responsible for is called their
3. When owners of a business can be held personally responsible for debts incurred by the business they have
4. With investors can only lose money that they have invested in a business.
5. A major disadvantage of a sole trader business is that limited access to makes growth and diversification difficult.
6. Only partners participate in the management of a partnership form of business.

7. All rules and regulations governing the operations of a partnership are outlined in a
8. Governments often give, such as lower tax rates, financial assistance and advice to encourage the establishment of sole trader businesses.
9. One of the main reasons why businesses are set up by private persons is to earn
10. Partnerships tend to have greater of existence than sole trader businesses.

(One mark for each correct answer: Total 10 marks)

Section B:

- a) Explain two advantages of the sole trader form of business organisation. (4 marks)

- b) (i) Explain two disadvantages of operating a business as a sole trader. (4 marks)

- (ii) Explain how the two disadvantages identified above can be overcome by converting to a partnership. (4 marks)

c) (i) Discuss two disadvantages which can be experienced if a business operates as a partnership. (4 marks)

(ii) Suggest how each of the disadvantages identified above can be solved. (4 marks)

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 30 marks

Session 2: Corporations

Introduction

In the last session you learnt about the sole trader and partnership forms of business organisations. Many of these exist in our modern day economy but they tend to be relatively small because of their inherent disadvantages of unlimited liability for owners. Many people may wish to pursue their dreams and open their own businesses but they are hesitant to risk very large sums of money. Corporations are the ideal form of businesses for these types of people.

In this session you will learn about corporations and realise why they tend to be more popular for larger investments. You will examine the two main types of corporations, which are private limited companies and public limited companies.

Upon completion of this session you will be able to:



Outcomes

Explain what a corporation is.

Describe the characteristics of a private limited company.

Describe the characteristics of a public limited company.

Distinguish between private and public limited companies.

What are Corporations?

Corporations are businesses which are established under special business laws to give them a legal identity or legal personality that is separate or distinct from their owners. As a result, all decisions and actions of the businesses are corporate obligations and owners are not held personally responsible for them.

Who are the owners of corporations? Owners are the persons or organisations that buy shares or stocks in the business and become part owners or shareholders. Hence the reason why corporations are also called **joint-stock companies**. This title indicates that many people jointly own the business, their part ownership being the value of the shares or stocks bought as investors. Additionally, corporations are also referred to as **limited liability companies** as the owners can lose only what was invested in the business and are not held personally responsible for its debts or commitments.

There are two types of corporations: private limited companies and public limited companies. You will now examine their main characteristics, similarities and differences.

Private Limited Companies

Nature of ownership

A private limited company is owned by a minimum of two shareholders or investors with no maximum limit. The shares of the company are not offered for sale to the general public and are usually owned by family members or private persons who might be invited to invest. Shareholders are not allowed to sell their shares without the consent of all other shareholders. Many private limited companies are family owned and operated and efforts are usually taken to keep the business “in the family”.

The name chosen for private limited companies must end with Ltd.



Activity

Look around at businesses in your country or check the telephone directory and advertisements in the newspapers for some examples of private limited companies operating in your country. Remember the key facts are that they will be family owned businesses and the name of the company will end with Ltd.

Procedure for formation

The regulations for the formation of a private limited company must be strictly followed and the required fees must be paid before this form of business can receive the legal permission to begin its operations.

You will recall that you learnt about the Registrar of Companies in Session 1 of this unit. Two documents which will be explained shortly must be prepared and submitted to the Registrar of Companies to seek approval for the formation of the business. These documents are the Memorandum of Association and the Articles of Association, and they are required for the formation of both private and public limited companies. It is advisable to retain the services of legal professionals to assist with their preparation. Let us examine the contents of these two documents.

1. The Memorandum of Association

This document contains the following six clauses:

- i. The name clause: this states the name of the company which must end with Ltd for private limited companies or Plc for public limited companies.
- ii. The situation clause: this gives the location of the registered office of the company and the exact address at which business correspondence will go.
- iii. The objects clause: this clearly outlines the purpose or objects for establishing the business. It is important to make this clause as all inclusive as possible because it determines what the company will or will not be able to do. If it is too limited and the company wishes to pursue an object that is not stated in this clause, it can be declared ultra vires or beyond the powers of the directors.
- iv. The liability clause: this states that the liability of the shareholders is limited to the amount that has been invested in the company.
- v. The capital clause: this is a statement of the amount of capital that will be used to establish the business. It outlines the types and nominal values of shares to be issued and the total amount of share capital that the business will raise from sale of its shares.
- vi. The association clause: this is a declaration made by the persons who are willing to be associated or linked with the formation of the company and the number of shares each will own.

The above clauses are known as the external relations of corporations.

2. The Articles of Association

This shows the internal operations of the organisation. It gives details on the internal management of the company and regulations for conducting business. The Articles of Association generally includes information on the following:

- i. Directors: This indicates how the Board of Directors, who have responsibility for formulating overall policies for the company, will be elected. The procedures for appointment and termination of directors, their powers, responsibilities and decision making processes are clearly outlined in the Articles of Association.

- ii. Shares: This covers all relevant information pertaining to types and values of shares and procedures for transfer of share ownership.
- iii. Dividends: The procedures for declaring and paying dividends to shareholders are stated. Dividends are profits that are given to shareholders as a reward for their investment in the company.
- iv. Meetings: Guidelines for convening and conducting meetings and the voting powers of shareholders are provided.
- v. Administrative matters: This gives information on legal issues relevant to the company, communication methods and procedures for auditing accounts.
- vi. Provisions for employees in the event of termination of the business.

The Memorandum of Association and Articles of Association provide the legal framework that will guide the operations of the company. Generally, the format will be the same for all companies but the details will depend on the size and complexity of the business.

When the Registrar of Companies approves the Memorandum of Association and the Articles of Association, it issues a Certificate of Incorporation.

A Certificate of Incorporation is the legal permission granted to corporations to indicate that they have been officially incorporated.

A private limited company can begin its business operations once it receives a Certificate of Incorporation.

Source of finance

The main source of finance in a private limited company is from the purchase of shares by the shareholders. There is thus greater share or equity capital potential than a sole trader or partnership, as there is no maximum limit to the number of shareholders.

Additionally the company can access extra finance from loans and this will form its loan capital. A portion of the company's profits, as agreed upon by the shareholders, can also be "ploughed back" into the business to provide additional finance for the company. This is called retained profits.

Type of liability

All shareholders in a private limited company enjoy **limited liability** and can only lose the amount of money invested in the company in the event of business failure. Shareholders cannot be held personally liable for the debts of the company.

Management and control

A **Board of Directors** has responsibility for formulating the overall policies for a private limited company. The directors are elected by the shareholders and their term of office, powers and responsibilities are clearly outlined in the Articles of Association. Generally, in family owned private limited companies, the Board of Directors are the family members who are also shareholders so they have both a professional and a personal interest in ensuring business success.

Managers are usually hired to implement the policies of the public limited company. They have responsibilities for the day to day running of the company. Managers also have to make sure that all financial accounts and records are properly prepared and made available to shareholders. These records are private and the business is under no obligation to release them publicly. However, financial accounts can be audited by the relevant government authorities to ensure the business' compliance with the laws of the country.

You will learn more about managers in Unit 6.

Sharing of profits and losses

Profits in a private limited company are distributed to shareholders in the form of **dividends**. The amount received will be based on the type and magnitude of share ownership. For the purposes of this course, only two types of shares will be explained: preference shares and ordinary shares.

Preference shares carry a fixed rate of dividend that the shareholders are entitled to, from the profits of the company. For example, 5% preference share means that for each share held the shareholder will receive dividends amounting to five percent return on his/her investment in shares.

Ordinary shares do not have a fixed rate of dividend; instead, the share of the profits that ordinary shareholders will receive is determined at the company's Annual General Meeting (AGM).

Preference shareholders receive their dividends first or in preference to ordinary shareholders but they do not have voting power at meetings. It is interesting to note that after preference shareholders are paid, the remaining profits will be allocated to ordinary shareholders in proportion

to their shareholding. Sometimes the dividend paid per ordinary share can be more than the fixed rate received by the preference shareholders. However, in years when the company's profits are not very high, ordinary shareholders may receive very little or no dividends after the preference shareholders are paid. This is the reason why ordinary shareholders are often described as the real risk bearers of a company.

If a company suffers losses, shareholders will not receive any dividends. In the event that the company goes out of business, shareholders can only lose the money invested for purchase of share.

Tax issues

A private limited company files its own tax return and pays corporation taxes on the profit earned from business operations. However, each shareholder will have to include any dividends received as part of personal income and this will then be taxed at the personal income tax rate.



Discussion

Discuss, with your classmates/tutor, the benefits of choosing to establish a business as a private limited company instead of as a sole trader or partnership.

Check the points you discussed to see how they match the advantages of establishing a private limited company listed below.

	Advantages of a Private Limited Company
1	Limited liability: All owners or shareholders enjoy limited liability. This is an incentive for people to invest as their risk of loss can only be the amount of money invested.
2	Greater access to finance: The limited liability advantage enables the business to attract many investors, giving it access to additional money to finance operations.
3	Accounts are private: Privacy of accounts can serve as an additional incentive to investors who may not wish to have the nature and extent of their investments disclosed publicly.

Advantages of a Private Limited Company	
4	Guaranteed continuity of the business: The legal life of a private limited company is not directly affected by the departure of owners because it has a separate legal identity and existence as a corporation. Thus this form of business has guaranteed continuity of existence from the owner's point of view. In addition, family members usually have the pride and loyalty to carry on a family business tradition.



Reflection

What do you think about the restriction of shares to family members and chosen people in a private limited company? Do you believe this can be a disadvantage? Are there any other disadvantages of operating a business as a private limited company?

You will now examine the disadvantages of operating a business as a private limited company. See how many of these points you were able to identify in your reflection.

Disadvantages of a Private Limited Company	
1	Limit to transfer of shares: Share ownership is not freely transferable and shareholders must get approval from all shareholders before they can sell their shares.
2	Access to capital is still limited: Even though the private limited company has greater access to capital than the sole trader and partnership, the possibility of raising share capital is still limited because shares are only offered for sale to family members and private people, and not to the general public. The latter option can give the business even greater access to funds but it is not pursued because of the private nature of ownership.
3	Double taxation: Shareholders may be subject to double taxation. This occurs because the company pays corporation taxes on its profits before dividends are distributed. When shareholders receive their dividends it becomes part of their personal income and is now subject to income taxes.

You will now switch your focus to the public limited liability company. As you proceed, you will notice that some of the characteristics are similar to the private limited company but there are a few features that are unique to the public limited company. Pay attention to these similarities and differences, as at the end of the session you will get the opportunity to do a comparative analysis of both forms of business organisations.

Public Limited Companies

Nature of ownership

A public limited company is owned by a minimum of seven shareholders and there is no maximum limit. Thousands of people, and even organisations, can have share ownership. The shares of the company are offered for sale to the general public and are freely transferable among people or organisations wishing to buy new shares or to sell the ones they possess. The stock market or stock exchange is the financial institution that facilitates the buying and selling of the shares of public limited companies. You will learn more about this in Unit 17.

The name chosen for a public limited company should technically end with plc. However, in reality many companies may only use Ltd or Limited.

Procedure for formation

The procedure for establishing a public limited company is the same as for a private limited company but there is an additional requirement. You can review the last section to refresh your memory of the Memorandum of Association and Articles of Association that have to be submitted and approved by the Registrar to get the Certificate of Incorporation. For a public limited company, the additional document that must be submitted is a Prospectus.

A Prospectus is an invitation to members of the public to subscribe to purchase shares that will be offered for sale by a public limited company.

When the Prospectus is approved by the Registrar, a Certificate of Trading is issued.

The Certificate of Trading is the legal permission which gives a public limited company the authority to offer shares for sale to the public.

The Registrar of Companies usually grants approval for the public limited company to sell a specified number of shares to raise a certain amount of money. This amount is known as the Authorised Share Capital.

When people buy this first offering of shares that the public limited company sells, the money paid goes directly into the business and becomes share capital to finance its operations. The shares are usually either preference or ordinary shares, just like those used by the private limited companies, with shareholders enjoying the same rights to receive dividends and to have limited liability. However, if someone who bought shares no longer wants them, they can be sold as second hand shares on the stock exchange. Also if a person did not buy from the company's new issue of shares but wishes to invest in the company, shares can be bought from those being offered for sale on the stock exchange. With these transactions, money is now transferred between the buyers and sellers of the shares but the relevant adjustments to share ownership are made on the company's share register.

Source of finance

Like the private limited company, the main sources of finance for the public limited company are from:

- Sale of shares
- Loans
- Retained or "ploughed back" profit when the company is actually operating.

The public limited company has the advantage of being able to raise much larger amounts of share capital than the private limited company. This is because it can sell shares as well as borrow from the public. There is no maximum limit to the number of shareholders a public limited company can have. The only limit will be that which is set by the Registrar of Companies when it gives approval for the maximum amount of authorised share capital that the company applies for permission to raise.

Consider the following example:

A public limited company has been granted approval to issue and sell the following shares: 200 000 preference shares at a price of \$10 each and 500 000 ordinary shares at a price of \$3 each.

The authorised share capital this company can acquire from the sale of these shares will be:

$$200\,000 \times \$10 = \$2\,000\,000 +$$

$$500\,000 \times \$3 = \$1\,500\,000$$

$$\text{Total capital} = \$3\,500\,000$$

This company can raise three and a half million dollars from the sale of shares to the public.

A public limited company has the authority to take loans from both financial institutions and members of the public. Borrowing from the public is not a privilege that any other form of business enjoys. The public limited companies can do this through debentures when approval is granted by the Registrar of Companies.

Debentures are loans borrowed from the public. The procedure to do this is similar to the offering of shares for sale to the public, but instead of people becoming owners of the company, they become creditors. Examine the following scenario:

If a public limited company wants to borrow five million dollars, it can offer for sale to the public one thousand debentures, each with a value of five thousand dollars. The debentures will be for a stated period of time and interest rate, for example, three years at an annual rate of interest of 10%. What this means is that the company is going to borrow five million dollars for three years and pay an interest rate of 10% to the lenders.

You may be wondering how the process described above actually takes place. Well, the debentures are advertised for sale to the public and people who have money to invest will purchase the amount desired. Thus, suppose you buy ten debentures; you are, in effect, lending the company fifty thousand dollars for three years. For each of the three years, you will earn an interest rate of \$5000 that the company will pay. At the end of the three years the company will redeem the debentures and repay you the fifty thousand dollars that you had lent it when the debentures were bought.

Type of liability

All shareholders in a public limited company enjoy **limited liability** and can only lose the amount of money invested in the company in the event of business failure. Shareholders cannot be held personally liable for the debts of the company.

Management and control

A **Board of Directors** has responsibility for formulating the overall policies for a public limited company. Like the private limited company, the term of office, powers and responsibilities of directors are clearly outlined in the Articles of Association. You can review this in the previous section of this session.

Unlike the private limited company, the very large number of shareholders in a public limited company can only wield influence over its operations through their voting powers. At an Annual General Meeting (AGM), shareholders get the opportunity to elect the members of the

Board of Directors. Managers are hired and given the responsibility of running the business and ensuring that there is a profitable return for the investors.

The operations of a public limited company are closely monitored by the government through a Securities Exchange Commission. The commission is established by the government to ensure that public limited companies adhere to their legal responsibilities. This is primarily because such a large segment of shareholders are members of the public and the government wants to ensure that their interests are protected. Unlike the private limited company, there is the requirement of public disclosure of information so that proper investments can be made by interested parties.

The yearly financial accounts of public limited companies must be:

- Published in the company's annual general report and distributed to all shareholders
- Submitted by a specified date to the Securities Exchange Commission
- Published in the newspapers for public viewing

Sharing of profits and losses

Like a private limited company, the profit earned by a public limited company will be distributed to shareholders in the form of dividends. The dividends paid per shareholder will be based on the type and magnitude of share ownership. Losses are borne in proportion to shareholding and a shareholder can only lose the maximum amount of money invested in the business.

Tax issues

A public limited company files its own tax return and pays corporation taxes on the profit made. However, each shareholder will have to include any dividends received as part of personal income and will be taxed accordingly.

Let us now examine the advantages of the public limited company. Examine the table below.

#	Advantages of the Public Limited Company
1	Limited liability: All shareholders enjoy limited liability so this makes people more willing to invest in the company. As a result, public limited companies can afford to engage in large scale operations.
2	Greater access to capital: The sale of shares and debentures to the public give the public limited company the possibility of raising huge amounts of capital to finance its large scale operations.
3	Lower unit costs or economies of scale: The large scale operations of a public limited company allow it to gain discounts on purchases and lower interest rates on loans and other expenses. This results in reduced average costs of production which can increase the profitability prospects of the company.

The above advantages result in the predominance of public limited companies in many countries today. However, there is one inherent disadvantage of this form of business, as identified below.

	Disadvantage of the Public Limited Company
1	Possibility of a takeover: The fact that shares are openly sold on the stock exchange can make a public limited company liable to a takeover. This can occur if, for example, Company A buys shares in a Company B until it secures a majority of share ownership and then makes a mandatory bid to take over control of the company. Thus a public limited company, especially a successful one that others may want to own, has to be alert for the risk of a takeover that will cause the present management to lose control.

Careful monitoring of the trend in share purchases can ward off potential takeovers. However, if companies do wish to join, a more responsible approach would be discussions for a mutual merger.

Session Summary



Summary

In this unit you learnt about the two main types of corporations, which are private limited companies and public limited companies.

The main characteristics of the private limited company are:

It is owned by a minimum of two shareholders with no maximum limit; shares are not offered for sale to the public and are instead owned by family members or private people who might be invited to invest.

- ✓ To officially begin its business operations, a Memorandum of Association and Articles of Association must be submitted to the Registrar of Companies to get the Certificate of Incorporation.
- ✓ The sources of finance are the purchase of shares by the shareholders, loans and retained profits.
- ✓ All shareholders enjoy limited liability.
- ✓ The private limited company is managed by a Board of Directors which is usually made up of family members and shareholders who have both a professional and a personal interest in ensuring business success.
- ✓ Profit in a private limited company is distributed to shareholders in the form of dividends.
- ✓ A private limited company files its own tax return and pays corporation taxes on its profit.

The main characteristics of the public limited company are:

- ✓ It is owned by a minimum of seven shareholders with no maximum limit. Company shares are offered for sale to the general public and are freely transferable among people or organisations wishing to buy or to sell on the stock exchange.
- ✓ To officially begin its business operations, both a Certificate of Incorporation and Certificate of Trading must be issued by the Registrar of Companies.
- ✓ The main sources of finance are from the sale of shares to the public, loans, sale of debentures and retained or “ploughed back” profit.
- ✓ All shareholders enjoy limited liability and, in the event of business failure, can only lose the amount of money invested in the company.
- ✓ The operations of the public limited company are closely monitored by the Securities Exchange Commission.
- ✓ Shareholders receive dividends from profit earned, based on the type and magnitude of share ownership.
- ✓ A public limited company files its own tax return and pays corporation taxes on its profit.

Assessment



Assessment

This session assessment consists of two sections.

Section A consists of a structured question, requiring you to write a few sentences for each of the three parts. You should spend fifteen minutes on this question.

Section B is made up of ten multiple choice questions. You are required to choose the letter which corresponds with the most appropriate answer. You should spend ten minutes on this section.

Section A:

(a) Identify two differences between a private limited company and a public limited company. (4 marks)

(b) Explain two benefits a business can enjoy if it is converted from a private limited company to a public limited company. (4 marks)

(c) Outline one major disadvantage of a public limited company. (2 marks)

Total: 10 marks

Section B:

Choose the letter which corresponds with the most appropriate answer to the following ten multiple choice questions.

1. The document which relates to directors' power in making contracts for a company is the
 - (a) Certificate of Incorporation.
 - (b) Certificate of Trading.
 - (c) Articles of Association.
 - (d) Memorandum of Association.

2. Which of the following measures may NOT be used by a limited liability company to raise capital?
 - (a) selling of shares
 - (b) borrowing from banks
 - (c) issuing debentures
 - (d) adding to existing inventory

_____S.SC_____
Sunscape Services Company Limited
54 Kings Highway
Cocorite
PORT OF SPAIN
Telephone: 686-1000
Directors: F. Good, T. Angel and I. Glory (Managing Director)

Use the above information to answer Question 3.

3. The letterhead heading indicates that the business is a
 - (a) private company.
 - (b) sole trading company.
 - (c) co-operative society.
 - (d) public company.

4. One of the features of a private limited company is
 - (a) shares are sold to the public on the stock exchange.
 - (b) ownership of shares are transferrable.
 - (c) shares are not sold to the public on the stock exchange.
 - (d) shareholders are elected to make decisions on behalf of the company.

5. A major disadvantage of a limited liability company is
 - (a) a separate legal identity.
 - (b) paying taxes.
 - (c) limited liability.
 - (d) easy transfer of ownership rights.

6. The owners of a company are known as:
 - (a) members.
 - (b) partners.
 - (c) sole trader.
 - (d) shareholders.

7. The share of profit a shareholder obtains is known as
 - (a) a gratuity.
 - (b) the dividend.
 - (c) the share of profit.
 - (d) a return.

8. Which one of the following documents is not used to register a limited liability company?
- (a) Memorandum of Association
 - (b) Articles of Association
 - (c) invoice
 - (d) list of Directors
9. A type of loan borrowed by a company is
- (a) a bank loan.
 - (b) a mortgage loan.
 - (c) shares.
 - (d) debentures.
10. The number of shares approved for issue by a company to prospective shareholders is called
- (a) authorised share capital.
 - (b) issued share capital.
 - (c) debentures.
 - (d) mortgage loan.

Total: 10 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 20 Marks

Session 3: Franchise Businesses, Multinational Corporations and Conglomerates

Introduction

"Nike, Adidas, Puma". Most of us are quite familiar with these popular brand names for sports shoes and clothes. *"KFC, Subway, Domino's and Burger King"* are some of the accepted fast food outlets that are ever present in almost every country in the world today. *"Nestle and Unilever"* operate in over one hundred countries, producing many of the products that are common household names: think of *"Gerber, Hellman's, Coffeemate, Lux and Colgate"*. These brand names serve to introduce you to some popular internationally renowned businesses and their brand name products.

In this session you will get the opportunity to learn about special types of business arrangements which have made these brand names so popular throughout the world. You will examine the characteristics of franchises, multinational corporations and conglomerates.

Upon completion of this unit you will be able to:



Outcomes

Explain what a franchise business is.

State the advantage and disadvantages of franchise businesses.

Explain what a multinational corporation is.

Outline reasons for the predominance of multinational corporations.

State the advantages and disadvantages of multinational corporations.

Explain what a conglomerate is.

Identify the advantages and disadvantages of a conglomerate.

Franchise business

A franchise is a legal right granted by a parent company to an independent owner/operator to establish a business to manufacture or distribute its branded product. The franchisor is the incorporated parent company that established the business and developed the product,

trademark or brand name and built its “goodwill” or excellent reputation. The franchisor grants a franchise to a franchisee, who becomes the owner of the particular business. The franchisee can choose the legal form of business desired. Some persons may wish to operate the franchise as a sole trader, while others may choose a partnership or incorporated company. However, all franchise businesses must adhere to certain conditions, as stated by the franchisor.

A franchisee is obligated to do the following:

- Use the trademark and name of the franchisor
- Bear the costs of setting up the independent retail outlet
- Follow specifications given by the franchisor for the layout of the premises and operation of the business
- Finance all operating expenses
- Sell only the product(s) that the franchisor authorises
- Pay the franchisor an initial fee for the franchise
- Pay a specified percentage of the profits earned, as a royalty to the franchisor, during the entire life of the business

Despite these obligations, franchise businesses are extremely popular in our contemporary business environment. Let us now identify a few examples of franchise businesses that most of us may be quite familiar with as they tend to be located in different areas within a country, as well as in many different countries. See how many you are able to recognise.

Examples of Franchise Businesses

Focus of business operation	Brand name of franchise
Food production and distribution	Kentucky Fried Chicken (KFC), Subway, Pizza Hut, Burger King, Haagen Daz
Clothing production and distribution	Nike, Adidas, Puma, Bluegrass
Hotels	Hilton, Marriot, Holiday Inn

Focus of business operation	Brand name of franchise
Health and beauty care products	Victoria's Secret, Bath and Body, Avon
Automotive	Toyota, Nissan
Retailing	K-Mart, Pricesmart, Macy's, Walmart



Reflection

The prevalence and popularity of franchise businesses indicate that there must be benefits from this type of arrangement for both the franchisor and franchisee. Think about a franchise business that exists in your country. What are the benefits enjoyed by the franchisee? What about the franchisor?

You can now check to see how many of the benefits you were able to identify. Examine the benefits of a franchise business in the table below.

Benefits of a Franchise business

Benefits to the Franchisor	Benefits to the Franchisee
The franchisor gets the opportunity to expand operations in different parts of the home country, as well as other countries. This is achieved without having to incur any expenses for establishing or operating the outlet, as these are borne by the franchisee.	The franchisee has the opportunity to establish and own a business that already has a recognised brand name. Thus there is no need to try and build its own reputation, as this is inherited from the franchisor's goodwill.
The franchisor earns money immediately when the franchisee pays the fee to get the franchise.	The franchisee receives training and advice from the franchisor to establish and operate the business.
The franchisor is assured of a continuing source of income from the royalty that the franchisee has to pay from its profits.	The franchisee does not have to spend money on marketing strategies, such as advertising, as this is done at a national level by the parent company.



Reflection

Would you like to get the opportunity to own a franchise business, like KFC? Most likely, the idea of getting a “ready-made” business is enticing because of the benefits just outlined. However, spend some time thinking about if there are any disadvantages of owning a franchise, and write down any points you can come up with.

Let us see if you came up with any of the following points.

Disadvantages of a Franchise business

Disadvantages to the franchisor	Disadvantages to the franchisee
If an individual franchisee does something that results in legal action being taken, it is the incorporated parent company that will be held legally responsible. Thus the reputation of the trade name can be adversely affected by irresponsible actions of a franchisee.	The royalty that has to be paid to the franchisor reduces the amount of profit that the franchisee makes. After a while, this may become a disincentive to continuing the business.
	If the franchisor goes out of business, the franchise will end. This can be a great financial loss for the franchisee.

Multinational Corporations

A multinational corporation (MNC), as the name implies, is an incorporated business that operates in many nations or countries. A multinational corporation has its head office or headquarters in its home country and branches of its operations in host countries. Unlike the franchise businesses that you learnt about in the last section, a multinational corporation finances the setting up of its branches in the different host countries and retains ownership of them all.

Some examples of multinational corporations which presently operate in our contemporary global economy include the following:

Name of multinational corporation	Type of productive activity	Home country/ headquarters of parent company	Host countries
Nestle	Production and distribution of dairy products, cereals, confectionery and chocolates, and pet food under brand names such as Smarties, Gerber, Nestum, Coffeemate and Proplan.	Switzerland	Operations in over 106 countries across the continents of Africa, Asia, Europe and Oceania.
Unilever	Production of brand name products in areas which include food: Flora, Hellmans, Bertolli, Lipton. Personal care: Dove, Lifebuoy, Ponds, Vaseline. Home care: Comfort, Breeze.	England	Products are manufactured in 100 countries and sold to 170 countries. Employs approximately 163 000 persons worldwide.
British Gas (BG)	Exploration, production and distribution of oil and gas energy.	United Kingdom	BG has operations in over 25 countries in five continents.

Name of multinational corporation	Type of productive activity	Home country/ headquarters of parent company	Host countries
Nike Company Limited	Production and distribution of athletic clothing and shoes with ownership of brand names such as Nike, Converse, Hurley and Umbro.	United States of America	Nike has operations in over 160 countries with 30 000 employees across six continents.

You will notice that these multinational corporations originate in developed countries and have branches in host countries throughout the world. They are also involved in a wide range of production activities of both goods and services. I am sure that you were able to recognise some of the brand names.



Activity

Conduct research to find out which of these multinational corporations operate in your country, as well as if there are any others which were not mentioned in this session.

In the scrapbook which you started in Unit 2, write the names of such corporations and the type of productive activities in which they are engaged. Insert pictures of the businesses where possible.



Discussion

Why do you think multinational corporations decide to set up branches in other countries? Discuss with your classmates the advantages these businesses enjoy from worldwide operations. Do you think the host countries benefit from their presence? Share your thoughts on this.

Let us now see how the points raised in your discussion compare with the following facts.

Reasons for predominance of multinational corporations:

Some of the reasons why multinational corporations are located in countries throughout the world include the following advantages:

- a) Easy access to raw materials for production: Multinational corporations seek to establish plants in countries where the necessary raw materials or natural resources are readily

available. This can save time and costs, and also enable greater efficiency and profitability in operations.

For example, the multinational corporations which are involved in extracting oil and natural gas, and mining gold, coal and bauxite will have operations in countries where these natural resources are abundantly available.

- b) Lower labour costs: Wages usually account for a large percent of production costs in some businesses. Thus multinational corporations are attracted to countries where labour costs are relatively low as this helps to reduce production expenses and increase profit margins. Training programs are often undertaken to ensure that people in the host country acquire the necessary skills and expertise to work in the companies.

- c) Incentives granted by governments of host countries: Governments, in an attempt to attract multinational corporations to establish operations in their countries, usually offer them special terms and conditions to serve as incentives. These may include:
 - Tax concessions: This is where the government may reduce or even eliminate the tax rates that the business will pay on imports of input to be used in production; also, the multinational may be granted a tax relief and not be obligated to pay taxes from profit earned for a certain period of time. These incentives serve to lower the production costs of the multinational corporations.
 - Land leases and access to natural resources: These give the multinational corporations a guarantee of the right to use natural resources so both short and long term business plans can be implemented.
 - Privileges to repatriate or send profits to their home countries.

- d) Easy access to international markets: The establishment of branches of their operations in various host countries give multinational corporations direct access to local markets there. These guaranteed markets help to increase sales volume and can contribute significantly to the success and profitability of the multinational corporation.

Were you able to identify these points in your previous discussion? If so, good work! Let us continue and examine the benefits that host countries can enjoy from the presence of multinational corporations.

Advantages of multinational corporations to host countries
<p>They provide capital: Multinational corporations are an important source of capital for host countries which often do not have sufficient local capital for development of businesses.</p>
<p>They generate employment and train locals: When multinational corporations establish branches in host countries they usually employ local people, as well as provide training for those who do not possess the required skills. This proves to be beneficial in improving the level of employment and the skills base of the labour force of the host countries.</p>
<p>They increase the quantity of goods and services produced locally: The production activities of the branch of the multinational serves to increase the total output of goods and services, which is also called Gross Domestic Product (GDP), of the host countries. This will contribute to economic growth and development in these countries.</p>
<p>They bring technology: Multinational corporations usually have the resources to undertake research and development and to acquire updated technology. This technology is then transferred to host countries and contributes to increased productivity.</p>
<p>They contribute to tax revenue for government: The governments of host countries are able to benefit from additional tax revenue gained from the branches of multinational corporations that operate in their countries. The two sources of tax revenue are:</p> <ol style="list-style-type: none"> 1) Corporation taxes paid on profits earned from operations locally. 2) Income taxes paid by the employees of the businesses.
<p>They contribute to social development: Most branches of multinational corporations honour their social responsibility by making contributions to the social development of host countries. Areas of assistance include making charitable donations, sponsoring cultural and sporting activities, granting scholarships, providing opportunities for internship and on-the-job programs for youth, and beautifying public areas.</p>

Despite the benefits outlined above, sometimes the presence of multinational corporations may cause negative effects on host countries. Let us now examine these.

Disadvantages of multinational corporations to host countries
<p>They repatriate profits: A large portion of profits earned by branches of multinational corporations is repatriated or sent to their home countries. These profits are first converted into the currency of the home country, and host countries have to facilitate this conversion. This reduces the stocks of foreign exchange in host countries and can adversely affect their ability to finance imports.</p>
<p>They may evade payment of taxes: Multinational corporations can avoid paying taxes in host countries that have high tax rates. This is done by transferring money to countries that charge lower taxes.</p>
<p>They contribute to depletion of natural resources: Many multinational corporations are attracted to host countries because of their abundant supply of natural resources. However, sometimes extensive operations may result in the depletion of natural resources; this limits the country's ability to achieve sustainable development.</p>
<p>They demand special concessions: Sometimes the special concessions, such as tax relief and long term leases for access to natural resources and huge expanses of land that multinational corporations demand, can prove to be detrimental to host countries. The tax relief reduces the amount of tax revenue that the government would have been able to collect. Long term land leases prevent locals from having access to resources.</p>
<p>They may have negative effects on third parties: Sometimes certain operations of multinational corporations may impose negative effects on third parties or people who are not directly involved in the business. This may occur in cases of pollution or the displacement of citizens who live near areas of natural resource.</p>

Conglomerates

A conglomerate refers to a corporation that owns several businesses from different types of industries. The businesses are known as subsidiaries and they are all under the corporate ownership of a parent company, which is usually a public limited company. A conglomerate can be formed when the parent company merges with, or acquires ownership of, firms from different types of production or industries.

Each subsidiary in a conglomerate operates independently as a separate business entity. Subsidiaries may take any of the legal forms of business organisations that you learnt about in the last two sessions of this unit. Subsidiaries may be found in many different countries, which makes the conglomerate a multinational one. Subsidiaries can also be franchise businesses, which you learnt about in the last section of this session.

Let us examine some examples of conglomerates before we attempt to outline the merits of this type of business arrangement.

Some examples of conglomerates include the following:

- **Neal and Massy Holdings Limited:** The parent company is in Trinidad and Tobago. This conglomerate owns businesses engaged in trading, manufacturing, finance and insurance. The subsidiaries operate under names such as Industrial Gases Ltd., Neal and Massy Motors Ltd., Borde Communications Ltd., Trading and Distribution Ltd., Caribbean Home Insurance Ltd. and Barbados Shipping Ltd.
- **Walt Disney Company:** The parent company is in the United States of America and this is the largest conglomerate in media and entertainment. It owns businesses engaged in animation, live-action film production, theatre, radio, publishing and online media. You may be familiar with some of these operations owned by Disney: Walt Disney Motion Pictures in Hollywood, cable television networks such as Disney Channel, ABC Family and ESPN. This conglomerate also owns and has licensed eleven theme parks to operate around the world.
- **The Dangote Group:** This conglomerate operates from its headquarters in Lagos, Nigeria and has business operations in a wide range of areas, including cement, beverages, pasta, sugar, real estate, oil, natural gas, telecommunications and steel. Some of the subsidiaries in this conglomerate are Dangote Cement Plc., Dangote Salt Plc., Dangote Flour Mills Plc., Dangote Sugar Refinery Plc., Dangote Oil & Gas Industries International, Dansa Foods Limited, DancomTechnologies and Dangote Textiles Limited.
- **The Hashoo Group:** This conglomerate, which operates from Pakistan, has businesses engaged in cotton trading, hospitality, oil and gas exploration and production, information technology,

investments, minerals, pharmaceuticals, ceramics, travel, tourism and real estate. Some of the subsidiary companies include Pakistan Marriot Hotel, Pearl Continental Hotels, Orient Petroleum International Inc., Net-21 (Pvt) Limited, Gelcaps (Pakistan) Ltd., Murtaza Construction Company (Pvt) Limited and Zaver Mining Company Limited.

Are you familiar with any of these companies?



Discussion

From the above examples you will notice that the subsidiaries of a conglomerate are normally engaged in a wide range of operations and also in many different countries. Can you identify any advantages of this type of business arrangement? Discuss them with your classmates/tutor.

Advantages of conglomerates
Protection against over specialisation: The diversity of operations in various types of industries provides protection from the danger of over specialisation in only one type of industry.
Spreading of risks: By investing in a range of industries and countries, a conglomerate can spread the risk of loss as it is less likely for all the businesses to fail at the same time.
Redistribution of resources: A conglomerate has the ability to transfer resources from profitable businesses to assist those which may be experiencing financial problems.

Session Summary



Summary

In this unit you learned about three special types of business arrangements, examining the characteristics of franchises, multinational corporations and conglomerates. These characteristics are summarised for you in the table below.

Franchise Business	Multinational corporation	Conglomerate
Owns and operates a brand name business through a special licence granted by the parent company or franchisor	Owns and operates branches in different host countries	Owns and operates businesses in different types industries
Advantages: The franchisee benefits from: -an inherited popular brand name -training and advice -national advertising	Advantages: In host countries, an MNC: -gets easy access to raw materials -receives incentives from governments -enjoys low labour costs	Advantages: The diversity of operations facilitate: -protection against over specialisation -spreading of risks -redistribution of resources

Table showing the characteristics of franchises, multinational corporations and conglomerates

Assessment



Assessment

This assessment consists of 3 sections. Write a few sentences for each answer required. You should spend 40-60 minutes researching and writing your answers.

1. Imagine you have just inherited some money and would like to open a business to sell fast food, such as chicken, chips and hamburgers.

(a) Identify two reasons why you may consider buying a franchise rather than using a new brand name that you can develop. (2 Marks)

(b) State two possible disadvantages that may be encountered in operating as a franchisee. (2 Marks)

2. Country A has large reserves of crude oil which are not presently utilized. The government is considering offering incentives to major multinational corporations to entice them to set up branches, drill for oil, refine oil and produce a range of petrochemical products.

(a) Describe three ways in which Country A will benefit if a multinational corporation is allowed to operate there. (6 Marks)

(b) Do you anticipate any disadvantages for Country A if it hosts a multinational corporation? Explain your answer. (2 Marks)

3. "The conglomerate form of business operation is becoming increasingly popular". A friend has come to you for an explanation of this comment, which he heard on a radio talk show about present business trends.

(a) Explain what a conglomerate is. (2 Marks)

(b) Give three reasons that highlight the benefits enjoyed by conglomerates, and which help to account for their increasing popularity. (6 Marks)

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 20 Marks

Session 4: Co-operatives

Introduction

What does it mean to co-operate? You are right if you answered that co-operating means working together with others to achieve a common goal. Do you co-operate with anyone to do anything in particular? Why? Is it because the benefits will be greater if efforts are combined than if you are working alone? Is it also because it feels good to help and be helped by others? Think about these questions for a few minutes, and then focus your thoughts on how the values of co-operating can be translated to a business setting.

Your thoughts on the questions raised above will help you to appreciate the form of business called co-operatives, which will be explored in this session. The essential principle of a co-operative is to serve and promote the economic welfare of people who have a common interest. This is basically done through three main types of co-operatives that exist to address the financial needs of people, as well as the interests of consumers and producers.

In this session you will get the opportunity to learn about the three types of co-operatives, which are consumer, producer and financial co-operatives. The first section of the session will identify the features which are common to all three types, and then the subsequent sections will highlight the unique characteristics of each type of co-operative.

Upon completion of this session you will be able to:



Outcomes

Explain the main characteristics of a co-operative.

Distinguish among producer, consumer and financial co-operatives.

What are Co-operatives?

Nature of ownership

The owners of a co-operative are called members. A co-operative is a business organisation made up of a minimum of two members who have a common interest and want to improve their economic welfare and fulfill certain identified needs.

For example, the common interest may be that the members are all consumers and they want goods and services that are conveniently available at reasonable prices, in an environment over which they have some control. This desire can result in the formation of a **consumer co-operative**.

Or, people may be producers of a particular good or service and they decide to co-operate, pool their resources and purchase capital equipment to be used collectively. By now you may have guessed that this common interest can result in the formation of the **producer co-operative**.

The **financial co-operative** is developed from the common need to save and to have access to loans at reasonable terms and conditions. You will learn more about these three types of co-operatives later on in this session.

A main feature of a co-operative is **open membership**. This means that people are free to join and buy as many shares as they wish. There are no restrictions on share ownership. However, sometimes membership to a particular type of co-operative may be open to only specific people; for example, a poultry farmers' co-operative will only accept members who are poultry farmers, as they will have common interests, goals and skills and may be able to work together more effectively.

Procedure for formation

A co-operative must register with the Supervisor of Co-operatives or the relevant authority in specific countries. The Memorandum of Association and Articles of Association must be submitted to the Supervisor. Registration incorporates the co-operative and allows it to have a legal separate entity, similar to that of a corporation. The minimum number of members required for formation of a co-operative is two and there is no maximum limit.

Source of finance

The main source of finance for a co-operative is share capital derived from the **purchase of shares by members**. Like other forms of businesses, it also has the option of **borrowing** to acquire additional funds, as well as **retaining a portion of the profits** earned to use for business operations.

All co-operatives are required by law to establish and maintain a compulsory capital reserve fund from surpluses made. All financial statements and accounts of the co-operative are available only to its members and not the general public. However, financial statements are inspected and audited by the relevant government authorities to ensure compliance with laws.

Type of liability

Members of a co-operative enjoy **limited liability**. Thus if the business should close down, members will only lose the value of shares bought.

Management and control

A committee has responsibility for management of a co-operative. The committee is usually formed from the membership and is elected by members at the Annual General Meeting. The committee is made up of a Chairman, Secretary, Treasurer and other committee members. Acting on its principle of democracy, each member is entitled to one vote irrespective of the number of shares owned.

The guiding principles for the operations of a co-operative are embodied in its **bye laws**. This will outline the rules and regulations that will govern the organisation and address issues similar to that of the Articles of Association of limited companies. These will include the powers, duties and responsibilities of the management committee, membership, share ownership, voting powers and conduct of meetings.

A unique feature of a co-operative is the emphasis placed on **continuous education of its members**. Deliberate steps are taken to provide training for its members and employees on a wide range of topics for economic, financial, professional and even personal development. There is also much sharing of information with members of the public about the goals and objectives of the organisation and its benefits.

Sharing of profits and losses

The main focus of a co-operative is not really to make a profit, but the earning of profit can be an additional incentive for members to participate in this business organisation.

The profit earned by a co-operative may be used in the following ways after corporation taxes are paid:

- **Payment of dividends** to members in proportion to their shareholding.
- **Payment of patronage refund** which is something like a bonus given to members, and is based on the extent to which they utilised the services of the co-operative.
- **Retain a portion** of the profit to use for financing business operations.
- **Reserve a portion** of the profit for a **special fund** to provide training, benefits and assistance to members.

Tax issues

A co-operative files its own tax return and pays corporation taxes on the profit made from the business operations. However, each member will

have to include any dividends received as part of personal income and will be taxed accordingly.

Consumer Co-operatives

The main principle of a consumer co-operative is to offer a wide range of goods for sale to members at reasonable prices. Members pool resources and establish a retail outlet. Some members also serve on the management team and as employees. Goods for the business are bought in bulk to obtain discounts. There is no need to engage in marketing strategies as members are already aware of the business. All this enables the consumer co-operative to keep costs at a minimum and to sell goods at lower prices than other retail outlets. Members also have the additional benefit of being able to qualify for a patronage refund, which is something like a bonus that is given based on the amount of purchases made in a given period of time. When profit is made, members also receive dividends.

Producer Co-operatives

Producer co-operatives are formed by people who are engaged in the production of a similar good or service. They unite to provide members with assistance in areas such as:

- Bulk purchasing of raw materials or other input in order to lower production costs
- Common purchasing of equipment, with use to be rotated as needed
- Pooling of skills and sharing of expertise to improve production operations
- Providing collective support for addressing issues that impact their operations

Some examples of producer co-operatives are evident among farmers who are engaged in areas such as rearing poultry or producing agricultural crops such as citrus and sugar cane; also, people engaged in providing services such as taxi drivers and entertainers may form co-operatives.



Discussion

Some farmers in your community are thinking of forming a producer co-operative. Discuss the benefits they can derive from this type of organisation. Do you think they would encounter any problems from being members of a co-operative? Share your thoughts with your classmates/tutor.

Financial Co-operatives

The main type of financial co-operative is the credit union. You will learn more about the actual operations of credit unions in Unit 17. However, for the purpose of this session, a brief explanation will suffice.

A credit union is basically formed to provide financial services to members belonging to similar occupations, professions or groups. Some examples of credit unions in Trinidad and Tobago are found among teachers, police, Muslims, Hindus, Christians, and oil field workers, to name a few.

Members are encouraged to save and pool their resources in the credit union through the purchase of shares. From this pool of money, members are granted loans up to a maximum of 150% of their shareholding. For example, if a member has twenty thousand dollars in shares, he can qualify for a loan of thirty thousand dollars. The shares are held as security until the loan is repaid. The interest rate is charged on the declining balance owed on the loans and is usually much lower than what is charged by other financial institutions, such as banks.

Credit unions also provide educational workshops on money management and areas of interest for its members. They provide other benefits, such as grants to meet funeral expenses of members, and offer scholarships and bursaries to deserving members and their children.



Activity

Conduct research to get one example of a producer co-operative, a consumer co-operative and a financial co-operative which operate in your country. Write a brief description of each of these co-operatives in your scrapbook which you started in Unit 1. The description of each co-operative should include its name, its main purpose and at least two benefits people who are members of the co-operative enjoy.

Session Summary



Summary

In this unit you learnt that co-operatives are voluntarily formed businesses which are democratically operated with the aim of meeting their members' needs financially and efficiently.

There are three main types of co-operatives: producer, consumer and financial.

The main principle of a consumer co-operative is to offer a wide range of goods for sale to members at reasonable prices.

Producer co-operatives are formed to provide assistance to their members, who are engaged in the production of a similar good or service.

A credit union is basically formed among people belonging to similar occupations, professions or groups. They are encouraged to save and pool their resources in the credit union to provide low interest loans to members.

Session 5: Public Sector Organisations

Introduction

Are all the goods and services you need produced only by businesses which belong to the private sector in your country? Does the government in your country operate any business which offers goods and services for sale? Do you think these would have been sold at lower prices if privately owned businesses were selling them? Are any goods and services provided to citizens for free by your government?

You will recall that in Unit 1 Session 4 you learnt about the mixed economic system, which comprises both private and public sectors. Additionally, you saw in Unit 2 Session 1 that the main role of businesses in the public sector is to ensure the collective welfare of citizens. In this session, you will take a closer look at public sector business activities which are usually undertaken by central government departments, local government authorities and public corporations.

Upon completion of this unit you will be able to:



Outcomes

Explain what public sector activities are.

Describe the role of the central government in producing goods and services.

State the main production activities of local government.

Explain the main characteristics of public corporations.

Define outsourcing.

What are Public Sector activities?



Reflection

Focus for a while on goods and services that are provided by the government of your country. Can you name some that you and your family are able to enjoy without having to pay? Are you thinking about roads, police protection, public hospitals and schools? Reflect on the last four sessions of this unit and what you learnt about businesses in the private sector and the kinds of goods and services they provide. Do they produce and provide the same types of goods and services as the government? Are any goods given out for free to anyone?

Public sector activities are undertaken by the government of a country for the production and delivery of certain essential goods and services. Many of these goods and services produced by the public sector are provided for free. The cost of producing them are financed by the government from taxes collected. You will learn more about taxes in Unit 22. Some examples of goods and services produced by the public sector include streetlights, army and fire services, as well as roads, schools and hospitals, which were mentioned in the previous paragraph.

The main objective of production activities in the public sector is to ensure the safety and welfare of its citizens. You will recognise this from the types of goods and services that it provides.

The range and types of public sector activities that a government engages in will vary in different countries depending on many factors, such as the type of economic system which exists. Recall Unit 1 where you learnt about the different types of economic systems. In countries with planned economic systems, public sector activities are more prevalent than in countries that have free and mixed economic systems.

The activities of production and delivery of goods and services by the public sector can be classified under four main areas, as shown in the diagram below:

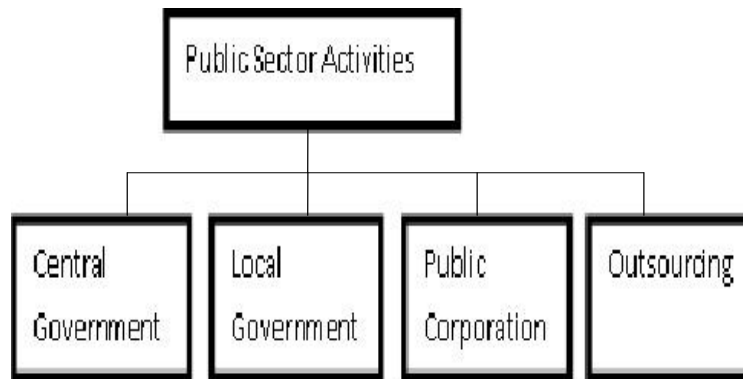


Figure 7: Main areas of public sector activities

Let us now examine each of these areas of public sector activities.

Central Government

Central government focuses on activities that affect the entire nation. In most countries, the central government delegates authority to ministries/ departments/agencies to undertake responsibility for matters in certain key areas.

Areas central government tends to focus on include:

- Agriculture
- Defense, security and justice
- Education
- Energy
- Finance
- Health
- Labour
- Local Government
- Social Development
- Transport and communications
- Public utilities and infrastructure

Each ministry is headed by a Minister who is either elected by the citizens of the country or appointed by the government. The Minister is ultimately held accountable for the goals of each ministry. The Minister is supported by a team of experts who have responsibility for day to day operations and implementation of policies. The employees of the ministry are public sector workers and are paid by the government.

Ministries receive funding from the central government based on allocations stipulated in the annual national budget. They have non-financial objectives and focus on public policies and meeting essential needs that ensure the welfare of citizens. Operations undertaken are not generally required to meet the private sector business criteria of success, such as profit maximisation. As such, most goods and services are provided free or at a very small cost.

As we proceed with this session, we will use the Ministry of Education in Trinidad and Tobago as an example to illustrate public sector activities.

The Ministry of Education in Trinidad and Tobago has responsibility for providing educational opportunities and facilities for all persons from early childhood to the compulsory age of education, which is 16 years. To fulfill this responsibility, the government finances the construction of schools, equips them with the necessary furniture and supplies, and employs and pays the salaries of all teachers and staff. Children are given the opportunity to attend these schools free of charge. The Ministry also has administrative departments and employees to look after the relevant personnel, financial and infrastructural issues, thus ensuring that there is effective delivery of education in the country.



Activity

In the scrapbook you started in Unit 1, start a new section entitled “Economic activities in the public sector”.

Make a list of at least three ministries in your country and the departments that comprise each ministry. State the goods and/or services provided by each and if prices are charged for them.



Discussion

Discuss these questions with your classmates. Are the goods and services produced by the public sector in your country essential goods or luxuries? How do they contribute to your welfare and safety?

Local Government

Local government focuses on activities in specific areas or communities of a country. The areas are often referred to as municipalities/counties/parishes/boroughs, depending on the country under consideration. Through local government elections, a Mayor or Councillor is chosen to head each municipality. The central government usually assigns a ministry to oversee the operations of local government authorities to ensure that they are consistent with overall national policies.

- Local government has responsibility for activities such as:
- Garbage collection
- Maintenance of parks, recreation grounds and cemeteries
- Maintenance of local (not major) roads, surrounding banks and canals.
- Maintenance of local public buildings like markets and community centres
- Public health
- Social welfare assistance

Funding to finance activities of local government authorities is basically derived from:

- Allocations received from the central government
- Money collected from residents paying local taxes, such as land and buildings tax.

So the next time you hear the garbage collectors outside your home or see workers cleaning the parks or roadways, you will remember that is your local government authorities at work in your community.

Public Corporations

Public corporations are also called state enterprises or state corporations. They are businesses established and owned by the state and they produce goods and/or services to sell directly to consumers. Each corporation operates as a separate legal entity, which means that legal action can be taken against the corporation but not against the government.

A public corporation is governed by the Minister in charge of the relevant ministry on whose behalf it operates. For example, a state corporation, such as the National Agricultural Marketing and Development Corporation (NAMDEVCO) of Trinidad and Tobago will be under the authority of the Ministry of Agriculture.

A public corporation is run by a Board of Directors appointed by the government. The Board of Directors has the responsibility for the day to day operations of the corporation to meet stated objectives.

A public corporation operates as an independent business producing and selling its goods and/or services to consumers. Its sources of finance are basically revenue derived from its sales and grants given by the government. A public corporation is required to publicly publish its annual financial accounts.

Like private sector businesses, public corporations have financial objectives and are expected to meet the criteria for business success. This means they must operate efficiently, and try to keep costs of production low in order to make profit. When profit is made, they become part of government revenue and can be reinvested in the corporation or used to assist in financing other public sector activities.

State corporations have to fulfil specified responsibilities on behalf of the government in provision of the particular goods and services. If any losses are made or debts are incurred by a corporation, the task ultimately falls on the government to meet this burden. This is necessary in order to keep the business in operation in the interest of the public.

State corporations can be formed in the following ways:

By statutes or laws: This is when the government legislates or passes special laws/statutes that give the legal authority to establish a corporation which will operate as a separate legal business entity. This type of public corporation is also called a Statutory Authority.

Nationalisation: This occurs when the government buys a business that was privately owned so it now becomes a state owned corporation, operating in the public sector as a separate legal entity.



Discussion

Why do you think a government would want to take ownership and control of a private sector business? Can you think of any cases where this was done in your country? If so, discuss the effects that nationalisation had on your country.

Let us now examine the major reasons for nationalisation and look at the benefits that can accrue to the country.

Reasons usually put forward to support nationalisation include:

To save a declining business: Sometimes a major privately owned business may wish to close down and the government may step in and buy it. The reason for this is to inject capital required to save the business and to protect the jobs of people employed there. Note that this does not apply to every business that is facing difficulties. The business has to be one that bestows significant benefits on the public and has the potential to make an important contribution to social and economic development.

To prevent the formation of private monopolies: Sometimes a privately owned business, especially one that is providing a vital good or service, may become so large that it controls almost the entire market. Decisions made by such businesses may focus on private rather than public interest. The government may undertake nationalisation to transfer decision making to the state and facilitate regulation of the business. This can result in benefits such as lower prices, increased output and efficiency, and the ability to facilitate overall planning for the economy.

To retain profits for national rather than private use: The government may seek to acquire ownership of a very profitable private business so that the profits can go to the nation rather than to a few private owners. This increase in government revenue can assist with financing projects that can contribute to the social and economic development of the

country.

In the table below you can will two examples of state corporations formed by statutes and nationalisation in Trinidad and Tobago. These public corporations are both under the authority of the Ministry of Energy.

Examples of State Corporations in Trinidad and Tobago

Statutory Corporations	Nationalised Industries
National Gas Company: This business was established with the responsibility of processing and distributing natural gas both locally and internationally.	Petrotrin: This is the country's major oil refinery, which was formerly owned by the multinational corporation called Texaco. It was nationalised when the owners were closing down operations in Trinidad.

Figure 1

Let us now develop our example of the Ministry of Education in Trinidad and Tobago to see how public corporations are used to facilitate the delivery of education in the country. Some of the public corporations the government has established to assist with fulfilling the responsibilities of this ministry include the following:

Education Facilities Company Ltd.: This public corporation is responsible for supplying the physical needs of schools, such as buildings and infrastructure.

National Schools' Dietary Services Ltd: This corporation looks after the provision of meals for students, as requested by the Ministry of Education.

School Laboratory Equipment Maintenance Unit (SLEMU): This corporation has responsibility for servicing equipment in the laboratories of schools.

Outsourcing

Outsourcing refers to giving out contracts to independent third party businesses to fulfil specific components of an organisation's operations. This practice is often used by the central government, local government and public corporations to assist with the provision of public sector activities.

Some of the ways in which outsourcing can be used by the public sector include the following:

- To help when a department does not possess the staff with the skills required for performing a specific function. For example, a ministry can outsource the servicing of its office equipment to a business that specialises in that job. This will free the staff to concentrate on their main office duties.
- To help if a large project has to be done and the organisation does not have the necessary equipment and personnel. For example, if the Ministry of Health wants to construct a new hospital, this job can be outsourced to a building contractor.
- To help when there are operations to be performed only at certain times or seasons. For example, if a ministry wants its financial accounts audited once a year, it can outsource this to an independent financial auditor.

Let us continue our example of the Ministry of Education in Trinidad and Tobago to see how outsourcing is used:

You will remember that one of the public corporations established by the Ministry of Education is the National Schools' Dietary Services Ltd., which was mentioned in the previous section. One of its responsibilities is to provide free breakfasts and lunches to a certain number of students. To fulfil this responsibility, this public corporation gives contracts to many small private businesses to cater these meals to schools throughout the country.

Similarly, the Education Facilities Company Ltd. may use outsourcing for the provision of furniture and the construction of buildings for schools.



Discussion

Identify other examples of outsourcing used by the government of your country. Discuss with your classmates how outsourcing can be beneficial to stakeholders.



Activity

To recap the four main areas of public sector activities you learnt about, the table below depicts examples of two ministries from Trinidad and Tobago. You are required to do research on your country and identify two other ministries. Identify at least one department, one public corporation and one example of outsourcing for each ministry. Add additional examples if you wish. Fill this information in the relevant spaces that have been left blank in the table.

Ministry	Departments and agencies	Public corporations	Examples of outsourcing
Finance	Inland Revenue Customs and Excise Investments Divestments	Trinidad & Tobago Unit Trust Corporation National Enterprises Ltd. Tourism and Industrial Development Company Trinidad & Tobago (Caribbean Airlines) Caribbean Investment Corporation T&T Development Finance Ltd. First Citizens Bank Ltd.	Actuarial Services
Energy	Energy Policy Planning and Research	National Gas Company of T&T Limited National Quarries Company Ltd Petroleum Company of	On land oil well drilling Servicing and maintenance of machinery and equipment Housekeeping (daily cleaning of the buildings and

Ministry	Departments and agencies	Public corporations	Examples of outsourcing
		<p>T&T Ltd (Petrotrin)</p> <p>Lake Asphalt of T&T Ltd</p> <p>La Brea Industrial Development Corporation</p> <p>National Energy Corporation of T&T Ltd</p> <p>Powergen</p> <p>Phoenix Park Gas Processors Ltd</p>	<p>offices)</p>

Ministry	Departments and agencies	Public corporations	Examples of outsourcing

Figure 2

Session Summary



Summary

In this unit you learned about public sector organisations, which are usually controlled by central government ministries, local government authorities and public corporations.

Central government focuses on activities that affect the entire nation in certain key areas, such as agriculture, health, defense and education, to name a few.

Local government focuses on activities in specific areas of a country, with emphasis on areas such as garbage collection, public health, social assistance, and maintenance of parks, cemeteries, local roads, and public buildings.

Public corporations are owned by the government but they operate as separate business entities to produce goods and services to offer for sale to consumers.

Assessment



Assessment

This assessment is made up of two sections: Section A is a two-part structured question and Section B is five multiple choice questions.

Section A:

Use complete sentences in your answers.

1. (a) What are public sector activities? (2 marks)

(b) Identify one main area of public sector activity in your country. Explain how this activity is implemented. (5 marks)

(c) Do you have any recommendations for the improvement of the activity stated above in part (b)? Discuss. (3 marks)

Section A: 10 Marks

Section B:

Multiple choice questions: Circle the letter that corresponds with the most appropriate answer in each question.

1. Which of the following practices would NOT apply to a Statutory Corporation?
 - (a) The Board must prepare annual financial reports.
 - (b) The Chairman of the Board must be responsible for the distribution of profits.
 - (c) The members of the corporation must be appointed by the Minister of Parliament.
 - (d) The Board must follow the policy issued by the minister.

2. Which of the following is NOT a benefit of nationalisation?
 - (a) Increased opportunities for private ownership
 - (b) Profits are not repatriated
 - (c) Certain key industries become state owned
 - (d) Increased employment opportunities for citizens

3. Which of the following is NOT an advantage of government departments?
 - (a) Constraints of resources
 - (b) Organises the implementation of government policies
 - (c) Assists the government to meet the needs of people
 - (d) Manages the country into manageable portions

4. Outsourcing is when a government
 - (a) buys a privately owned business.
 - (b) gives the legal authority to establish a corporation.
 - (c) gives a contract to third party.
 - (d) prevents the formation or private monopoly.

5. Which of the following government ministries is concerned with the affairs of the community?

- (a) Labour
- (b) Local government
- (c) Education
- (d) Public utilities

Section B: 5 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Total: 15 Marks

Unit Summary



Summary

In this unit you learned about the legal forms of businesses that operate in both the private and public sectors of most countries.

The following table summarises the main characteristics of the legal forms of business organizations.

	Sole Trader	Partnership	Private Limited Company	Public Limited Company	Co-operative	Public corporation
Nature of ownership	1 owner	2 - 20 partners	Minimum 2 shareholders	Minimum 7 shareholders	Minimum 2 members	Owned by government
Source of finance	Personal savings Loans Retained profits	Partners' contributions Loans Retained profits	Sale of shares Loans Retained profits	Sale of shares Loans Retained profits	Members' contributions Loans Retained profits	Revenue from taxation Loans Retained profits
Procedure for formation	Relevant licence	Relevant licence Deed of Partnership	Relevant licence Certificate of Incorporation	Relevant licence Certificate of Incorporation Certificate of Trading	Relevant licence Bye Laws	Statutes Nationalisation
Liability	Unlimited	Limited	Limited	Limited	Limited	Limited
Management	By owner	By general partners	Board of Directors (usually family members)	Board of Directors elected by shareholders	Committee	Board of Directors appointed by government

	Sole Trader	Partnership	Private Limited Company	Public Limited Company	Co-operative	Public corporation
How Profits are used	All go to the owner	Shared among partners	To pay corporation taxes To shareholders as dividends To reinvest in business	To pay corporation taxes To shareholders as dividends To reinvest in business	Patronage refund to members To reinvest in business	To add to government revenue
Taxation	Personal income tax on profit	Personal income tax on profit	Corporation tax on company profit Personal income tax on dividends received by shareholders	Corporation tax on company profit Personal income tax on dividends received by shareholders	Personal income tax on profit	Corporation tax on profit

Figure 3

Assignment



Assignment

This assignment consists of ten multiple choice questions and a structured question based on a business scenario. When you are finished this assignment, mail it to your tutor for evaluation. You may be asked to include the session assessments you have completed and self-marked.

Multiple choice questions:

Circle the letter corresponding with the most appropriate answer for the following multiple choice questions. For each correct answer you will score one mark.

1. In which form of business organisation will the owner have unlimited liability?
 - a) Sole trader
 - b) General partnership
 - c) Corporations
 - d) All of the above

2. With respect to a general partnership, which of the following is not true?
 - a) The actions of all partners can bind the business.
 - b) All partners face unlimited liability.
 - c) At least one partner must have limited liability.
 - d) Profits earned by partners are taxed as personal income.

3. Which of the following shows how a partnership business differs from a sole trader?
 - a) The partnership has greater continuity of existence.
 - b) The partnership business has access to more start-up capital.
 - c) All owners do not face personal liability.
 - d) All of the above.

4. Private and public limited liability companies are similar in several ways. Which of the following shows how private and public limited liability companies are similar?
 - a) Shareholders in both types of companies have limited liability.

- b) Both companies have the same minimum number of shareholders.
 - c) Both companies must make their financial accounts public.
 - d) Both must get a Certificate of Trading to begin business.
5. One benefit of a multinational corporation is
- (a) increased employment.
 - (b) reduction of state ownership.
 - (c) decrease of material resources.
 - (d) repatriation of profits.
6. Which of the following is NOT a characteristic of a franchise?
- (a) Receives assistance from the parent company.
 - (b) Bears the name of the parent corporation.
 - (c) Licensed by the parent corporation.
 - (d) Receives assistance from the government.
7. Comprises of people coming together to make a financial business transaction A conglomerate company is when
- (a) two or more companies merge together.
 - (b) a company owns the majority of shares.
 - (c) a company owns the majority of shares in many countries.
 - (d) a group of people pool their resources.
8. Which of the following is NOT an advantage of a co-operative society?
- (a) Lacks speed in changing existing policies and/or making decisions.
 - (b) Members pool their resources.

- (c) Opportunity to build a strong financial base through low returns to members.
 - (d) Members have a say in the overall decision making.
9. The employees of “Converse Shoes” pool their money at the end of each week and buy their groceries at wholesale price. They are operating a
- (a) partnership company.
 - (b) private company.
 - (c) sole trading company.
 - (d) consumer co-operative.
10. The owner of the largest poultry farm in Debe has invited other poultry owners in the area to a meeting to discuss setting up a financial organisation to pool their resources. The type of organisation that will be formed is a
- (a) co-operative.
 - (b) partnership.
 - (c) sole trader.
 - (d) corporation.

Total: 10 Marks

Structured Question:

John is the proud owner of a CYBER CAFE which offers internet services at very reasonable prices to people in the community in which he lives. This business is quite successful and John enjoys many benefits.

- (a) What form of business do you think John has? (1 mark)

(b) State two benefits he enjoys from having this form of business.
(4 marks)

(c) Discuss three disadvantages John may experience because of the characteristics of this form of business. (6 marks)

Recently, some of John's customers have been asking for advice on purchasing computers. He is thinking of expanding the business to also offer computers and other accessories for sale. However, because of the large amount of money needed for this investment, John is thinking about changing the form of business organisation. John wants to know why there are different forms of business organisations and which one he should convert his business to. He has come to you for advice.

(d) Explain to John why there are different forms of business organisations. (4 marks)

- (e) What form of business organisation would you recommend to John?
Give reasons to support your recommendation. (10 marks)

Total: 25 Marks

Assignment Total: 35 Marks

Unit 4: Factors, Types and Levels of Production

Introduction

Today we are surrounded by a wide range of goods and services readily available to us. Have you ever considered what happens before we are able to buy a loaf of bread, a book or a computer, a car or a house? What do you think is necessary to make these goods? What makes possible the provision of services like banking, transport, communications and hairdressing? How can some countries produce on a large scale and have extra for sale abroad, while others have barely enough for their own population?

In this unit you will learn about the production process that enables us to have access to the wide variety of goods and services that are designed to satisfy our needs and wants.

Sessions 1 and 2 will explore the four factors of production and the special issues related to each one. In Session 3 you will see the classification of production into three main types. As you examine the industries unique to each type of production, you will understand the inter-relationships and linkages among them. Finally, you will be able to identify what determines the different levels of production practised by industries and countries.

Upon completion of this unit you will be able to:



Explain the production process.

Describe the factors necessary for the production of goods and services.

Discuss the role of entrepreneurs in production.

Classify the different types of production and industries.

Identify backward and forward industrial linkages.

Describe the levels of production.

The sessions in this unit are:

Session 1: Factors of Production

Session 2: Enterprise as a Factor of Production

Session 3: Types of Production and Industries

Session 4: Levels of Production

Time frame : Ten hours (10 hours)

Session 1: Factors of Production

Introduction

A wide variety of goods and services are produced by an equally wide variety of businesses in our modern day economy. Are there any common characteristics among these businesses? What do they need to make this production possible?

In this lesson you will learn about the production process and the factors of production that are necessary to facilitate it. You will examine the importance of and special issues related to each factor of production.

Upon completion of this session you will be able to:



Outcomes

Explain the concept of production.

Describe the four factors of production.

Show the link between natural resources and development of industries.

State the factors which affect the quantity and quality of labour.

Distinguish between different types of labour.

Assess the impact of migration on the labour supply.

Identify types of capital.



Terminology

Input:	Anything such as natural resources, labour, money and machinery used in the production process to make goods and services.
Output:	The amount of goods and services made from a production process.
Efficiency:	Using input to produce maximum output at minimum cost.
Firm:	An individual business unit engaged in the production of goods or services.
Industry:	The total number of firms engaged in the production of a particular good or service. For example, the computer industry is made up of several firms, which include DELL, APPLE, IBM and HP.
Factory:	The physical building or plant where the production and/or manufacturing of goods takes place.

What is the Production Process?

The production process is the system used to transform resources into goods and services.

The diagram below is a simple representation of the production process:



Figure 1

Resources are the inputs needed to enable production to take place. These are also called the factors of production. Industries, firms, businesses and individuals engage in production where various activities are undertaken to transform these resources into the output of goods and services to be offered for sale. Recall that you learnt in Unit 2 that output can serve as

both consumer and producer goods and services.

Factors of Production

There are four factors of production:

1. Land or Natural Resources
2. Labour or Human Resources
3. Capital or Man-made Resources
4. Enterprise

You will now examine the characteristics and importance of these factors.

Land as a factor of production

Land as a factor of production not only refers to the earth's surface or soil. It includes all mineral and chemical resources, such as the sun, air, sea, rivers and lakes. These are all gifts of nature and are thus called natural resources. All production begins with land.

Let us briefly examine some ways in which land is used in production:

The fertile soil is used for crop and livestock production to assist in meeting the world demand for food.

Trees from the forest are used to produce lumber and paper.

Chemical and mineral resources, e.g., crude oil, iron ore, bauxite, and gold, are extracted and converted into useful products such as gasoline, steel, aluminum and jewelry respectively.

The sun is valuable as a source of solar energy. This is a useful power supply, e.g., in Barbados most water heaters use solar energy rather than electricity. The sun also enhances agricultural production and promotes tourism.

The air or wind can be converted into wind power and used as a form of energy needed in production, e.g., in the Netherlands wind turbines provide power for the operation of machines.

Natural bodies of water are useful for production of seafood, such as fish and shrimp. Some fast flowing rivers, e.g., the Niagara River in Canada are harnessed to generate hydro electric power, which is an important alternative source of power for use in production.

The link between Industries and land

Generally the major industries which develop in a country are influenced by the quantity and quality of land available. This and the natural

resources possessed become major inputs in the production process of various industries.

Let us examine the main natural resources of two Caribbean countries and see how these have influenced the industries found there.

Refer to the table below.

Country	Main natural resource	Industries based on the natural resource
Trinidad & Tobago	Crude Oil	Oil refining, Gasoline, Kerosene, Petrochemicals and Plastics
	Natural Gas	Ammonia, Methanol, Urea, Liquefied Natural Gas (LNG), Electricity generation
	Asphalt	Road paving, Construction
Jamaica	Bauxite	Bauxite mining, Alumina
	Limestone	Construction, Cement
	Sea	Tourism, Fishing
	Fertile Soil	Agriculture and agro based industries based on extensive cultivation of Coffee, Bananas & Sugar Cane

Figure 2

This table above clearly shows that the production activities and industries of a country are definitely influenced by the natural resources it possesses.

However, an interesting point to note is that many countries have

industries even though they do not possess the natural resources required for production. For example, Trinidad and Tobago imports iron ore to facilitate production of iron and steel in one of its largest industries. Many countries also depend on imports of food crops to be processed in local factories. For example, most Caribbean countries import wheat from Canada and the USA to produce flour, which is a main staple food. Many canned foods, such as peas, carrots, corned beef, and even milk, which are packaged in your country may be using imported inputs. You can read the labels on these products to verify this.



Note it!

A country's endowment of land and natural resources, and its ability to acquire ones that it does not possess, greatly influence its patterns of production through the types of industries it is able to develop. This in turn impacts the country's economic growth, development and quality of life that its citizens enjoy.



Activity

(1) Choose a natural resource of any country you are familiar with and write down two industries which developed in the country based on the presence of that resource.

(2) Refer to a country you are familiar with and identify one industry existing there which developed even though the country does not possess the main natural resource required for production. State how the industry is able to get this input for production.

Labour as a factor of production

Labour refers to the work or effort of humans that is used in production. Do you think production can take place without any input from humans? If you answered no, you are correct. There can be no production without labour to start the process.

Businesses view labour as their human resources. This describes the total sum of all persons with the necessary knowledge, skills and abilities. The concept of human capital has been recently introduced to emphasise the value of people as important assets in a business. Human capital refers to the skills that workers have acquired from training and experience which serve to increase their value to the organisation.

The labour supply of a country consists of all people who are willing and able to work. The labour available in a country can be viewed from quantitative and qualitative perspectives.

Factors affecting the quantity of labour

The number of people who are available for work in a country at a particular time depends on many factors, which include the following:

1. **The size of the population:** Normally a country with a larger population should have more people available for work, as opposed to a country with a smaller population.
2. **The age structure of the population:** This refers to the number of people within different age ranges. In most countries, people between school leaving and retirement should be available for work. Thus if two countries have the same population size but one has more people between school leaving and retirement, it will have a larger labour supply than the other one.
3. **Cultural and social customs:** In some countries, tradition, culture and social customs can impact the number of people available for work. This is especially evident in Middle East countries like Saudi Arabia and Iran where local women are not allowed to work. So a country with the same size of population as Iran will have a larger labour supply as women are allowed to work.
4. **Migration:** Migration refers to the permanent movement of persons from one country or area to another. External migration occurs when people migrate from one country to another. If many people leave a country, this can reduce the number of people available to work. When people enter a country, this increases the supply of labour. Internal migration occurs when people move permanently from one area to another within the same country. A popular trend in many countries is for persons to move from rural to urban areas.



Discussion

Why do you think people migrate from one country to another? Discuss the positive and negative effects that migration can have on a country.

Refer to the Learners Guide for feedback.

Factors affecting the quality of labour

The quality of labour refers to the efficiency or productivity of workers. Labour productivity is output per worker or average output. It is calculated by dividing the total output by the number of workers, as shown below.

Labour Productivity = Total Output ÷ Number of workers

For example, in **Shoe Factory A**, if 10 workers produce 800 shoes per day then:

$$\text{Labour Productivity} = 800 \div 10 = 80$$

This means that on average each worker produces 80 shoes a day.

Compare this with **Shoe Factory B**, where 10 workers together produce 1000 shoes per day so:

$$\text{Labour productivity} = 1000 \div 10 = 100$$

This means on average each worker produces 100 shoes a day.

These examples suggest that Shoe Factory B has a higher level of labour productivity because the same number of workers can produce a larger output in a given period of time.



Reflection

Why do you think some people work better and faster than others? In the example above, why are workers in Factory B more productive than those in Factory A?

Refer to the next section to see how many of the points you were able to think about.

Factors that affect the productivity of labour

1. **Natural talent and ability:** Some people have natural or innate talents that make them highly productive.
2. **Acquired skills:** Generally, people can acquire skills and abilities through education, training and experience, and these serve to increase their productivity.
3. **Machines and tools:** If workers are using machines that are up-to-date and in good working condition, output will increase and labour can be more productive.
4. **Favourable working conditions:** The “people factor” is an important consideration when dealing with labour. Workers tend to be more productive if they are happy with their jobs and work in a safe, comfortable environment with good inter-personal relationships. Usually a healthy worker, in body, mind and spirit, tends to be more productive than one who is not healthy and happy.
5. **Migration:** The migration of skilled and highly qualified persons can negatively affect the quality of the labour supply. This is called a “brain drain” and this loss of skilled labour can have an adverse effect on productivity in the home country.

You will now examine the classification of different types of labour.

Types of labour

Human resources are very diverse and each person is unique and may possess different skills, talents and experience.



Reflection

Think for a moment about people you know who are either employed or self-employed. Do they all have the same level of education and skills? Do they all perform the same tasks?

Most likely you answered “no” to both questions. Types of labour can be classified based on the degree of skills and qualifications a person possesses. This in turn will determine the kinds of jobs they will be able to perform. Let us now examine the different types of labour.

Basically, labour can be classified into the following categories:

- (a) **Skilled labour:** This refers to persons with high levels of educational qualifications and training. This consists of professionals such as engineers, scientists, doctors, lawyers, teachers, accountants and managers.
- (b) **Semi-skilled labour:** This consists of persons who have undertaken some degree of formal, on-the-job training or apprenticeship to acquire skills and experience. Semi-skilled labour can be further classified into manual and supervisory jobs.

Examples of manual semi-skilled workers include carpenters, electricians, plumbers, drivers and mechanics.

Examples of supervisory semi-skilled workers include clerical staff, office clerks and supervisors.

- (c) **Unskilled labour:** This refers to persons who need little or no formal training to do a job. Examples include labourers, cleaners, sales clerks and security guards.

The pictures below show some types of labour.

A doctor providing professional medical service is an example of skilled labour.



Source:
http://upload.wikimedia.org/wikipedia/commons/0/0e/US_Navy_100215-N-4995K-125_Navy_doctors_perform_surgery_aboard_USNS_Comfort.jpg

Figure 3

A carpenter at work is an example of manual semi-skilled labour.




Source: http://farm5.static.flickr.com/4110/5009371856_957e198672.jpg

Figure 4

A shoemaker is an example of semi-skilled labour.



 Some rights reserved by [Retinafunk](#)

<http://www.flickr.com/photos/retinafunk/21461091/sizes/m/in/photostream/>

Figure 5

A janitor is an example of unskilled labour.



By [Frederick Md Publicity](#)

<http://www.flickr.com/photos/frederickmdrocks/3846977199/>

Figure 6



Activity

Think about five people you know who are working. Use the spaces provided below to make a list of the job done by each person. Identify the type of labour each one is engaged in and justify why you chose that category.

Job done by persons	Type of labour	Justification for choice of type of labour

You can check your responses with the information provided in the Learners Guide.

Why is Labour important in production?



Discussion

Discuss the following questions with your classmates/tutor.

Do you think any one person is more important than another in a business? Or is each person in the production process important in his/her own special function, regardless of the level of skills possessed?

Some persons think that skilled workers are more important than unskilled ones. What are the criteria for determining importance?

More important is a relative concept. Will the engineers be able to function if the semi-skilled and unskilled workers do not ensure that the building is clean, that the relevant files are typed or that there is adequate security on the premises?

The importance of labour in the production process

1. To initiate or start production: The production process cannot take place without the input of humans. Land and natural resources will remain idle unless people make decisions to use them. Labour is thus essential for developing, designing and inventing ideas on how to use land and natural resources in order to initiate production of new goods and services.
2. To facilitate production: Inputs of capital, such as machinery, tools and buildings, which facilitate the production process can never be invented, designed or produced without the intervention of man. The

management skills and physical and mental effort needed to enable the production of goods and services are provided by human resources. Ultimately the aim of production is to satisfy the needs and wants of man. Labour is also needed so goods and services can be transported and distributed to reach the final consumer.

You will now examine another factor of production: capital.

Capital as a Factor of Production

Capital is anything that is the result of past human effort that enables further production to take place. Many persons refer to capital as wealth creating new wealth. For capital to exist, the two factors which were described above, land and labour, must be combined.

The two main distinguishing features of capital are:

- Capital is produced by combining the factors land and labour.
- Capital enables the production of other goods and services.

Types of capital

Generally, capital can be classified as either fixed capital or working capital.

Fixed capital: Fixed capital refers to all goods that are used over and over again in the production process and for many production cycles. These goods are also called producer goods as they enable production to take place.

Fixed capital represents the long term assets of a business because they have value and can be used many times in the production process. Some examples of fixed capital include buildings, machinery, tools, equipment, and vehicles.



Activity

Look at the pictures below and identify the types of fixed capital which are being used. Write your answer in the lines provided below the pictures.



Figure 7 by [futuresun](#)

<http://www.flickr.com/photos/futuresun/5179737426/>

.....
.....



Figure 8 by [Marco Wessel](#)

Source: <http://www.flickr.com/photos/mhw/251613139/>

.....
.....

If you identified the following examples of fixed capital: fork lift, sewing machine, buildings, that is correct.

Working capital: Working capital includes goods that are used only once in the production process. It is also called circulating capital and, like fixed capital, working capital are producer goods as they enable production to take place.

Working capital is continually used up when production takes place and has to be replaced for the next production cycle. As such, working capital is referred to as the short term assets of a business. Examples of working capital include natural resources and raw materials, e.g. minerals and agricultural output, as well as any manufactured goods used to facilitate production, e.g., paper and bottles.



Activity

Look at the two pictures from the previous activity and now identify examples of working capital. Write your answer in the lines below.

.....
.....

Most likely you would have correctly identified the following examples of working capital: boxes, paper, cloth, thread.



Note it!

Fixed capital refers to all goods that are used over and over again in the production process, while working capital includes goods that are used only once in the production process.

A special type of working capital is financial capital. This refers to money, bank balances and financial instruments which represent money, such as shares and bonds. By itself, money cannot directly produce goods and services but its value as capital lies in the fact that it is essential for paying for all the other factors of production needed for production.



Activity

Where do businesses get financial capital? In the lines provided below make a list of possible sources of money for a business. You will recall you learnt about this in Unit 3.

.....
.....

Check your list with the information which will now be presented.

Sources of financial capital

Money to finance operations of a business can be obtained in the following ways:

- i **Personal savings:** Many people may save money and invest it in their own business.
- ii **Sale of Shares:** In some types of business organisations, for example, limited companies, shares are offered for sale. When people buy shares, this money becomes share capital for financing business operations. Shareholders are part owners of the business and are entitled to a share of the profit made.
- iii **Loans:** Many businesses borrow money and this is referred to as their loan capital. Money can be borrowed from friends, family, financial institutions and other lending agencies.
- iv **Retained Profits:** Some businesses make a decision to keep a portion of profits made to “plough back” into the business in order to have additional financial capital.
- v **Government Assistance:** Some businesses are given financial grants by the government to assist with their financial requirements. This is used as incentives, especially for the development of small businesses.

Why is capital important?

Capital is important because of the following reasons:

1. **To finance production:** Financial capital provides the money needed to purchase the inputs necessary to start up and keep a business in operation.
2. **To facilitate production:** Fixed and working capital, when used with the factors land and labour, enable production to take place.

Fixed capital, such as buildings, provides the physical place from which most businesses operate. Capital equipment like machinery and tools enable man to perform jobs and operations that would normally be beyond human ability, e.g., cranes to lift heavy materials. The use of machines also saves time and increases

efficiency of production, e.g., tractors to plough extensive areas of land. Other kinds of technical equipment enable man to perform complex operations in seconds, e.g., the use of computers.

Time is money in business. Even though the initial cost of acquiring fixed capital may be high, eventually the positive returns of increased output in a shorter time make the acquisition of fixed capital cost effective for most businesses in the long run.

Working capital is important to provide the raw materials and other inputs that are used for conversion into goods and services.

Enterprise as a factor of production

Many economists accept enterprise as the fourth factor of production as this focuses on the role of the entrepreneur. The entrepreneur is the person who accepts the risk of combining the other three factors of production (i.e. land, labour and capital), to produce the desired goods and services in the amounts required, so a profit can be gained. The next lesson will be devoted to a more in-depth analysis of the entrepreneur because this factor is crucial to the success or failure of a business.

Session Summary



Summary

In this session you learnt:

- ✓ The factors of production or inputs necessary for the production of goods and services are land, labour, capital and enterprise.
- ✓ Land includes all the natural resources present within, as well as the sun and sea. Generally, the resources possessed by a country tend to have a direct relationship to the type of industries that develop there.
- ✓ Labour or human resources are essential to all production. The quantity and quality of a country's labour supply affect efficiency and productivity.
- ✓ Capital as a factor of production provides the physical spaces, machinery, tools, raw materials and money to facilitate the production process.
- ✓ Enterprise is the input in the production process that co-ordinates the other three factors of production and assumes the risk of a business undertaking.

Assessment



Assessment

This assessment consists of one short answer question and ten multiple choice questions. You should spend thirty minutes on this assignment. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Short answer question:

Choose a good or service you would to produce by setting up your own business. Write a brief report identifying the factors of production that will be required for production of the good or service chosen. For each factor of production you identify, explain why it is necessary to the production process. (15 marks)

Multiple choice questions:

Circle the letter which corresponds with the most appropriate answer.
You will get one mark for each correct answer. (10 Marks)

1. The process of production converts:

- (a) Services into goods
- (b) Outputs into inputs
- (c) Inputs into output
- (d) Goods into services

2. Land as a factor of production includes all the following except

- (a) mineral resources
- (b) sun
- (c) forests
- (d) roads

3. Which one of the following industries is not based on the natural resource of oil?

- (a) gasoline
- (b) petrochemical
- (c) alumina
- (d) plastics

4. The supply of labour is NOT affected by

- (a) the birth rate.
- (b) the death rate
- (c) the unemployment rate.
- (d) the school leaving age.

5. The productivity of labour is negatively affected by
- (a) the training of workers.
 - (b) migration of workers.
 - (c) the use of machines.
 - (d) teamwork among workers.
6. The productivity of labour can be calculated by dividing
- (a) total output by number of workers.
 - (b) number of workers by total output.
 - (c) total profit by number of workers.
 - (d) total output by total revenue.
7. Mr. John works as the cleaner in your school. This type of labour can be classified as
- (a) skilled labour.
 - (b) semi-skilled manual labour.
 - (c) unskilled labour.
 - (d) undesirable labour.
8. Which of the following is an example of fixed capital in a business?
- (a) A car for private use
 - (b) A van for delivery of goods
 - (c) A loan received
 - (d) Goods purchased for resale

9. Which of the following is NOT a source of financial capital in a business?

- (a) Sale of shares
- (b) Personal savings
- (c) Dividends given to shareholders
- (d) Loans

10. The factor of production that assumes the risk of a business undertaking is called

- (a) land.
- (b) labour.
- (c) capital.
- (d) enterprise.

Total: 25 Marks

Session 2: Enterprise as a Factor of Production

Introduction

Do you want to own your own business? Do you have a unique idea for producing a good or service? Are you brave enough to develop this idea? Will you risk the money you presently have in the hope that you will gain greater financial independence? Do you want to be your own boss? Are you willing to work hard?

If your answers to these questions are all yes, then you have what it takes to be an entrepreneur!

In this session you will explore enterprise as a factor of production by focusing on the concept of entrepreneurship. You will be able to understand the characteristics and importance of the entrepreneur. You will also learn about how an entrepreneur can contribute to the success or failure of a business.

Upon completion of this session you will be able to:



Outcomes

Explain the concept of entrepreneurship.

Describe the roles and importance of entrepreneurs.

Identify the characteristics of successful entrepreneurs.

Discuss how the entrepreneur contributes to business success or failure.



Terminology

Business plan:

A blueprint outlining the objectives of a business and how they will be achieved.

Entrepreneurship

What is entrepreneurship? All great dreams begin with an idea. It is the willingness to pursue the idea, by acquiring what is necessary and remaining focused despite challenges, which enable dreams to become reality. The concept of entrepreneurship embraces the desire of a person to start a new business with the hope of gaining profit.

The roles and importance of entrepreneurs

Entrepreneurs are the people who turn business dreams into reality. The importance of entrepreneurs lies in the key roles they play in a business venture. You will now examine this.

Roles of an entrepreneur

1. **To initiate production:** Usually it is the entrepreneur who formulates an idea or opportunity for a business venture and then evaluates the idea to determine if it has the potential to develop into a successful business. This requires in-depth market research, which you will learn about in Unit 12.
2. **To prepare a business plan:** If the idea for the business has potential for success and a decision is taken to pursue it, the entrepreneur now has to prepare a business plan. A business plan is a blueprint which outlines the goals of a business and strategies for achieving them. You will be able to prepare a business plan by the end of this course.
3. **To implement the business plan:** The entrepreneur has to put measures in place to achieve the goals and objectives of the business plan. The success of the business will, to a large extent, depend on the entrepreneur accessing sufficient resources and using cost effective strategies.
4. **To decide what and how much goods and services to produce:** The entrepreneur has to ensure that the right amounts of inputs are acquired and combined in the right proportions to meet production targets so marketing needs can be successfully met.
5. **To monitor business operations:** This is important for the entrepreneur to be able to assess progress in meeting goals. The entrepreneur must be able to identify potential problems and take proactive measures to prevent them. If problems are identified, the entrepreneur has to adopt strategies to correct them. This will minimize delays and cost overruns, and will increase efficiency of business operations.
6. **To bear the risk of enterprise:** Ultimately it is the entrepreneur who bears the risk of enterprise and takes the risk of implementing an idea. If the business is successful, the entrepreneur reaps the benefits

and enjoys the profits. However, if the business fails, he/she will have to bear the losses. The desire to avoid the latter aids in motivating the entrepreneur to strive for success.

The many roles outlined above for the entrepreneur may seem daunting. However, this task has been done successfully by thousands of people in all sizes and types of business ventures. Usually, especially in larger businesses, the entrepreneur can get support by hiring people with relevant skills to assist in performing specific duties.

Characteristics of a successful entrepreneur



Reflection

Think about an entrepreneur in your country. What qualities contributed to making this person a successful entrepreneur? If you were to become an entrepreneur, what characteristics should you possess to be a success?

Compare the qualities you thought about with the ones identified below.

Goal oriented: An entrepreneur has a goal and is willing to undertake the risk of pursuing it. The successful entrepreneur is the person who is determined to pursue this goal and put the necessary measures in place to achieve it. The reward of this focused determination is usually a profitable and successful business.

Knowledgeable: A successful entrepreneur possesses skills and knowledge in the relevant areas of business activity. In addition, he/she acquires information on the environment in which the business operates. This knowledge is important as it allows the entrepreneur to be aware of the impact of stakeholders, to grasp new opportunities for markets and to keep abreast of any developments that can help to improve present practices.

Self-confident: This means believing in oneself and one's ability to achieve whatever is attempted. A successful entrepreneur is confident that his/her business idea is viable or possible. Plans are pursued with determination and he/she does not give up when faced with challenges. A successful entrepreneur is creative and self-assured, and can turn challenges into rewarding opportunities.

Willing to undertake risks: This refers to being brave enough to take a chance on something, even when there is no guarantee of success. An entrepreneur who is willing to take the risk on an original idea and venture into new areas will enjoy greater profit when the business is successful. In the business world, big risks can either bring big profits or big losses. The entrepreneur is the one who has to decide on the amount of risk that he/she is willing to undertake.

Proactive: A person who is proactive shows initiative by taking timely action rather than reacting to situations. A successful entrepreneur keeps ahead of the business and is always seeking new ways to innovate and refine the product. While monitoring the progress of a business, a proactive entrepreneur anticipates potential problems and takes timely action to prevent them from materializing.

In addition to the above characteristics, a successful entrepreneur must be hardworking, determined, efficient, committed, honest and of outstanding integrity.

Business success and the entrepreneur



Reflection

Think of an entrepreneur in your neighbourhood. Can you remember when their business was started? If not, ask the entrepreneur. Was the business always at its present size? Is there evidence that the business is successful, that it is making profit, employing more people or offering a wider range of goods for sale? How do you think the entrepreneur contributed to the success of this business?

Business success is generally assessed in terms of positive growth in sales, profits and size. Business failure is evident when sales have declined, resulting in losses and eventual closure of the operation. Generally, it is the entrepreneur who is held accountable for the success or failure of a business.

How an entrepreneur contributes to business success

1. **Possesses required characteristics:** An entrepreneur who possesses the desirable characteristics you learnt about in the previous section will be the main contributor to the success of a business.
2. **Effectively implements the business plan:** The entrepreneur who prepares a comprehensive business plan and ensures that it is effectively implemented puts a business on the path for success.
3. **Fosters positive relationships:** The entrepreneur who fosters and maintains good links with all stakeholders and keeps his employees motivated will contribute to the success of a business.
4. **Attempts innovation:** The entrepreneur who shows initiative, pursues new innovative ideas, attempts diversification, and is willing to develop the old by undertaking a greater degree of risk is the one most likely to achieve higher positive growth and success for a business.

It will now be clear to you that the entrepreneur is really the driving force behind a business. He/she is ultimately responsible for its success or failure. If the business is successful, the reward will be profit; if it fails, the burden of the losses will have to be borne.

Do you still want to own your own business and be an entrepreneur? If that is your goal, hopefully you do!

Session Summary



Summary

- ✓ In this session you learnt entrepreneurship embraces the desire of a person to start a new business with the hope of gaining success and profit.

- The entrepreneur is the person who performs the following roles in a business:
 - Prepares the business plan
 - Acquires the necessary inputs
 - Decides on how the inputs will be combined
 - Sets production targets
 - Monitors business progress
 - Resolves problems
 - Undertakes the risk of the business enterprise

- A business is usually successful because the entrepreneur possesses the following desirable qualities:
 - Goal oriented
 - Knowledgeable
 - Self confident
 - Proactive
 - Determined,
 - Committed
 - Honest

The success of a business ultimately depends on the skill and efficiency of the entrepreneur. When the business is successful, he/she is rewarded with profit but if it fails, he/she has to bear the burden of the losses.

Session 3: Types of Production and Industries

Introduction

We have come a long way from the heavy reliance on self sufficiency that was practiced in the early days of civilization to our modern day emphasis on highly specialised production. Today millions of people throughout the world are engaged in productive activities, producing a diverse range of goods and services.

In this lesson you will learn that basically each productive activity can be classified into one of three main types of production. You will see the different types of industries that are unique to each type of production and recognise how industries depend on each other.

Upon completion of this session you will be able to:



Outcomes

Identify the three types of production.

Name the industries unique to each type of production.

Organise a flow chart to illustrate the types of production involved in the making of goods.

Explain industrial linkages.

Types of Production

Recall that in Session 1 of this unit you learnt that production involves the use of inputs or factors of production to create output of goods and services.

The production process generally consists of three stages with each one representing a type of production. The three types of production are:

1. Primary production
2. Secondary production
3. Tertiary production

The diagram below illustrates the three types of production and highlights the different kinds of industries that are found in each type of production.

Diagram showing types of production

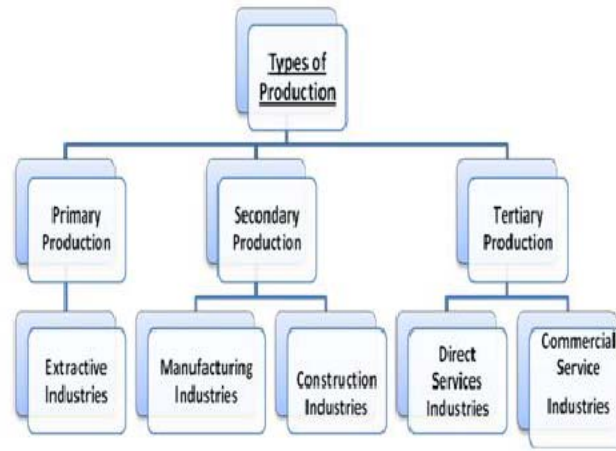


Figure 9

Let us now examine each type of production.

1. Primary production

Primary production, as the name suggests, is the first stage of the production process. It involves getting or extracting raw materials and natural resources from the land. You will recall that land, as a factor of production, includes natural bodies of water, the sun, forests and fertile soil. Industries which are engaged in obtaining these natural supplies from the land are called extractive or primary industries.

There are four main categories of primary or extractive industries, as shown in the diagram below:

Diagram showing primary or extractive Industries

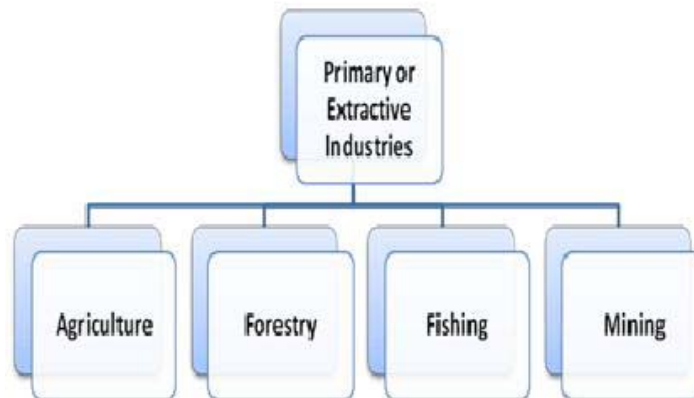


Figure 10

- i Primary industries involved in agriculture: In this type of production, the land is used for cultivating crops and rearing animals. Some examples of this category of primary production include growing and harvesting sugar cane, wheat, fruit and vegetables, and rearing of animals such as cows, goats, chickens and sheep.

Some of the output of these industries can be used in their natural state, for example, fruit such as oranges can be eaten directly. Or, the oranges can be used to make packaged orange juice but this activity will take place in secondary production. Other agricultural products, such as wheat, must be converted into a form that can be useful to man. This will take place in secondary production, where the wheat will be converted into flour.

The pictures below show people engaged in agriculture.



Source: http://farm6.static.flickr.com/5088/5367317878_a0e812a1ac_b.jpg

Figure 11



Source: http://farm6.static.flickr.com/5042/5304307229_3b2960b5a9_b.jpg

Figure 12

- ii Primary industries involved in forestry: Forestry, as a category of primary production, involves cutting down trees that grow naturally on land, as well as replanting new ones for future use. The timber from trees becomes raw materials in the production of lumber and paper in the second stage of production. These will then be used in other industries as an input, e.g., for the making of furniture and books.
- iii Primary industries involved in fishing: Fishing is viewed as an extractive industry because people involved in this activity take fish and other edible sea creatures like shrimp, crabs and lobsters

from the natural bodies of water. Like the other primary industries described above, the output from the fishing industry can be used for additional production activities, such as preserving or processing, which will take place in secondary industries.

- iv **Primary industries involved in mining:** Mining refers to all activities involved in extracting natural resources from the earth. Resources like crude oil, natural gas, coal, gold, bauxite, iron ore and limestone are useless if left in their natural places and state. Primary production industries have the responsibility of extracting these resources through activities like drilling for oil, mining for coal, gold, iron ore and bauxite, and quarrying for limestone and sand. You will remember in the session on “Factors of Production” that these natural resources usually form the basis of major industrial production in countries.

The picture below shows oil drilling.



Source: http://farm4.static.flickr.com/3472/3698117403_485329bd07_b.jpg

Figure 13



Activity

Refer to your scrapbook which you started in Unit 1. Start a new page and write the heading “Primary or Extractive Industries”. Use the businesses you identified previously to list which ones are engaged in primary production. For each business you identified, state the type of primary industry it represents. If you did not have any examples of these types of businesses, you will have to add new ones.

2. Secondary production

Secondary production, as the name suggests, is the second stage of the production process. Industries in secondary production are involved in converting the natural resources and raw materials obtained from the primary industries into useful products.

The two main categories of industries in secondary production are shown in the diagram below:

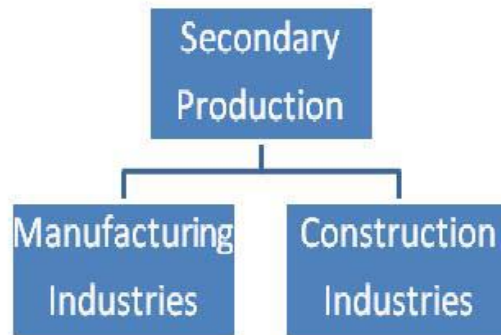


Figure 14

You will now examine each of these industries engaged in secondary production.

i **Manufacturing Industries**

Manufacturing industries are production units that convert raw materials and natural resources into finished products. These industries use the output from primary production as inputs in order to make both consumer goods and producer or capital goods.

Examine the table below. Column 1 lists examples of natural resources and raw materials that extractive industries from primary production would provide. Column 2 shows finished products that are made in secondary production by manufacturing industries, which convert inputs of raw materials acquired from primary production.

Natural Resource / Raw Materials acquired from Extractive Industries in Primary Production	Finished Products made by Manufacturing Industries in Secondary Production
Sugar cane, which is grown in the fertile soil.	Sugar and by-products like rum and molasses. Sugar is used as an input in other industries, e.g., candies and soft drinks.
Fruits and vegetables, cultivated in fertile soil.	Canned, frozen and dried fruits and vegetables, juices, jams and jellies.
Animals, e.g., cows and chickens, reared on land.	Canned meats, e.g., corned beef, frozen meats; processed meats e.g., burgers and sausages.
Trees in forests.	Lumber, which is used in construction and furniture industries. Pulp used to make paper.
Fish, shrimp, crabs from seas and rivers.	Frozen, dried and canned fish.
Gold from gold mines.	Jewelry.
Iron ore.	Steel products.
Crude oil.	Gasoline, kerosene, aviation fuel, petrochemicals, plastics.
Bauxite.	Aluminum products, e.g., aluminum foil, pots, airplanes.

Figure 15

From the examples shown in the table, it is clear that secondary production is dependent on inputs that have their origins in primary production.

Another type of industry included in the manufacturing sector of the secondary stage of production is assembly or “screw driver” industries. These put together components from different industries to make a whole product. Popular examples of these industries are assembling of cars, electronic equipment, computers and household appliances, e.g. stoves and refrigerators. Assembly industries are commonly found in countries where labour is plentiful and relatively cheap. Some of the more developed countries have even begun to use robots for assembling products like cars.

ii Construction industries

Construction industries put together a final product using inputs obtained from both extractive and manufacturing industries. Production activities in this type of secondary production include erecting buildings and infrastructure like roads and bridges.

The picture below shows a building under construction.



Source: http://farm4.static.flickr.com/3528/3696795341_d4ae21e5d3_b.jpg

Figure 16



Activity

Identify some inputs or products necessary for the construction of a house.

Some products required are sand, gravel, steel rods, cement, wood and paint.

Which of these products are used directly from extractive industries?

You are correct if you said sand and gravel.

Which of these products came from manufacturing industries?

Steel was manufactured in a smelter plant from the natural resource of iron ore, while wood had its origin in trees from the forest and was converted into that form in a sawmill.

The construction industry thus puts together outputs from both extractive and manufacturing industries to produce the final product. In this example, the final product is the house.

3. Tertiary production

Tertiary production provides services. You will remember from Unit 1 that services are intangible or nonmaterial acts which cannot be seen or touched. There are two categories of service industries in tertiary production, as shown in the diagram below:

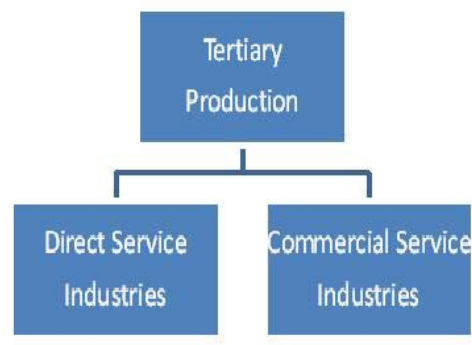


Figure 17

i Direct service industries

Direct service industries provide actions or functions that satisfy the needs and wants of persons. The interaction here is straight from the person providing the service to the person using it. Some

examples of direct service industries include education, health care, defense, and hairdressing. So the teacher, doctor, hairdresser and even the police officer are people providing direct services to meet your needs.

Pictures of businesses providing direct services to customers



Source:
http://upload.wikimedia.org/wikipedia/commons/0/0c/Drying_hair_in_salon.jpg

Figure 18: The direct service of hairdressing

ii Commercial service industries

Commercial service industries provide services that facilitate or enable production, distribution and consumption of goods and services. The major commercial service industries are engaged in trade, transport, communication, banking, insurance, warehousing and advertising.

Trade facilitates the buying and selling of goods and services. Businesses involved in trade are considered to be the final link in the production process as they make goods and services available to buyers. Both wholesale and retail outlets, such as vendors, shops, restaurants, malls and even the internet and eBay, provide this essential commercial service of offering for sale the wide range of goods and services that have been produced.

Picture of an online retailer



Source: Stock photos-DEU MOE

Figure19: Amazon.com, an online retailer

Transport industries enable the movement of raw materials, labour and capital to wherever they are needed for production. Transport also facilitates the delivery of finished goods to the trade outlets where they are offered for sale. Transport is done by land, sea and air and movements can be made both locally and internationally.



Figure 20: A truck transporting goods to a trade outlet



Source:
http://farm3.static.flickr.com/2396/2501913255_1257a1070e.jpg

Figure 21



Source:
<http://u1.ipernity.com/12/49/49/5674949.a9260254.560.jpg>

Figure 22

Communication industries perform the important function of enabling businesses to transmit information. This is vital in today's fast paced business environment where many global business deals are done at the touch of a button. Some of the businesses involved in providing communication services include post offices and telecommunication firms, which offer telephone, internet and satellite services.

Banks and other financial institutions provide important services to facilitate business activities. They enable businesses to access financial capital through loans and provide other useful services, such as accepting deposits, making payments, and arranging foreign exchange for international transactions. This contributes to increased efficiency in production. You will learn more about banks in Unit 16.

The insurance industry acts as a security against certain risks by providing financial compensation if specified events occur. For example, if a business has an insurance policy to cover losses that may occur due to natural hazards, when this happens the business will get money to recover its losses. This commercial service provided by insurance companies gives a degree of assurance to investors and encourages business development. You will learn more about insurance in Unit 18.

Warehousing is an important service that provides storage facilities for extra inputs and outputs to ensure that they are easily and readily available when needed.

Businesses engaged in advertising provide information about available goods and services to potential customers and persuade them to buy. Effective advertising contributes to increased sales and profitability for businesses.



Activity

Identify examples of activities that take place at the primary, secondary and tertiary stages of production so that you are able to go to a business and buy the following products:

- (a) Gas for vehicles (b) Bottled orange juice.

Now you can check your responses with the two illustrations that follow. The primary, secondary and tertiary stages of production of gas for vehicles are shown in the pictures below:

Primary production: extracting the natural resource of crude oil as shown in Figure 23.



Source: http://farm4.static.flickr.com/3472/3698117403_485329bd07_b.jpg

Figure 23

Secondary production: converting the crude oil into gas at an oil refinery as shown in Figure 24.



Source: http://upload.wikimedia.org/wikipedia/commons/thumb/c/c6/PikiWiki_Israel_5905_haifa_oil_refinery.jpg/800px-PikiWiki_Israel_5905_haifa_oil_refinery.jpg

Figure 24

Tertiary Production: Facilitating the sale of gas to consumers at a gas station, as shown below.



Source:
http://upload.wikimedia.org/wikipedia/commons/3/3c/Esso_gas_station_finland.png

Figure 25

This second illustration is a flow chart showing examples of the three types of production involved in the making of bottled orange juice.

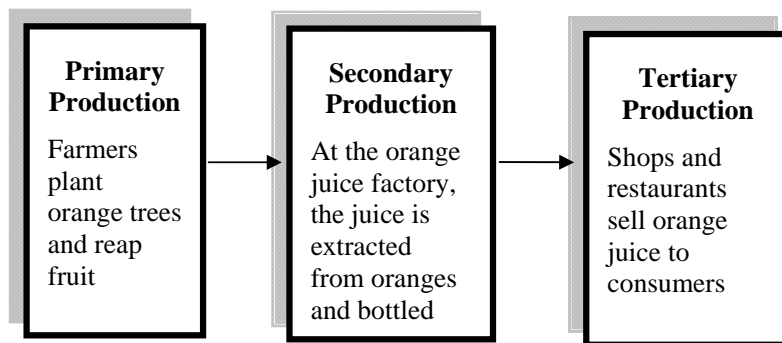


Figure 26

You will now take a look at a special relationship of linkages that exists among industries.

Industrial Linkages

From your study of types of production, you will realise that industries depend on each other. This dependence is what forms linkages among industries. Basically, there are two types of industrial linkages.

Types of industrial linkages

1. **Backward linkages:** These are industries which supply inputs to an identified industry. These inputs may be natural resources, manufactured goods or services.

Let us use the lumber industry as the identified industry. The lumber industry produces wood using timber from trees.



Reflection

Do you remember what type of industry supplies timber?

You are correct if you said extractive industries engaged in forestry. Thus the forestry industry from primary production is a backward linkage to the lumber industry. It provides the natural resource of timber to be used as an input in the lumber industry for the production of wood.

Do you think anything else is needed for producing wood?

If you are thinking about capital equipment, like machines and tools, as well as services such as transport and electricity, you are correct. The industries which produce these are also backward linkages as they supply inputs required to facilitate the production of wood in the lumber industry.

2. **Forward linkages:** These are industries which use the output of an identified industry as inputs. These linkages move a product closer to the final user.

The forward linkages to the lumber industry are businesses that use wood as inputs for production. These include manufacturing and construction industries that use wood to make furniture and buildings respectively. Other forward linkages are commercial service industries engaged in wholesale and retail trade that sell lumber.

Look at the flow diagram below to reinforce your understanding of linkage industries to the lumber industry.

Flow Diagram

Backward linkage industries - Main industry - Forward linkage industries

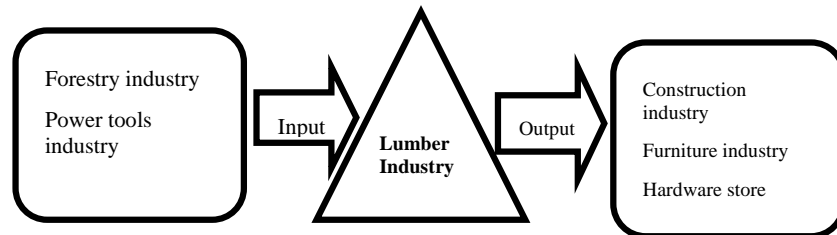


Figure 27

You can now view these industrial linkages for the lumber industry in the pictures below:

People are seen at work in the forest cutting trees to get timber. This is a backward linkage to the lumber industry.



Source:

<http://www.bing.com/images/search?q=picture+of+lumberjacks&FORM=IGRE#focal=db393369912ad865afadda02f7dac9a0&furl=http%3A%2F%2Fwww.chantryisland.com%2Flumberjacks.gif>

Figure 28

Timber becomes an input to the lumber industry, where it is converted into lumber or wood.



Source:

<http://www.bing.com/images/search?q=picture+sawmill+making+wood&go=&form=QBIR&qsn#focal=39b57cbbcbec96d7f368eeec7e225fd4&furl=http%3A%2F%2Fwww.wabashanderiecanal.com%2Fsubpage%2Fparktrails%2FWood-MizerSawmill.jpg>

Figure 29

The output of the lumber industry is used to make chairs in the furniture industry, which is a forward linkage.



Figure 30: Making of wooden furniture by [P.Flintandco](#)

<http://www.flickr.com/photos/pflintandco/4679522743/>

Please note that the transport industry is an important linkage in all industries as it provides the essential service of taking either inputs or outputs to where they are needed.



Activity

This activity should be done in your scrapbook. Start a new page entitled “Linkage Industries”. Choose one of the businesses you have identified. Identify two backward and two forward linkages industries to this business. Organise these linkages in a flow diagram, following the one shown in Figure 27.

Importance of industrial linkages

1. **Creation of employment:** Like all businesses, linkage industries create jobs. The more linkages that can be fostered locally, the greater the generation of employment will be. People will earn more income and be able to afford to buy more goods and services. This results in an improvement in their standard of living, which is one of the indicators that a country is achieving economic development.
2. **Provide a market for output:** The establishment of a major industry usually provides a market to which linkage industries can supply goods and services. For example, the establishment of a large hotel in an area may encourage people to go into business setting up souvenir shops nearby, providing transport services for guests, and even going into agriculture to supply fresh fruit, vegetables and meat for the preparation of meals in the hotel.
3. **Easy accessibility to inputs:** The presence of linkage industries, which provide inputs for other businesses, is beneficial as it assures easy accessibility and a ready supply of what is needed. This serves to increase the productivity and profitability of the businesses.

Overall development of linkages promotes economic activity in all types of production as industries serve each other; this has a positive impact on economic growth and development in the country.

Session Summary



Summary

- In this session you learned that there are three types of production based on each stage of the production process:
- Primary production extracts the raw materials and natural resources from the land. Extractive or primary industries that are involved in this first stage of production are agriculture, fishing, forestry and mining.
- Secondary production converts the output from primary production into useful products. This stage of production takes place in manufacturing and construction industries.
- Tertiary production involves the creation of services rather than physical goods. Direct service industries satisfy the wants of individuals while commercial service industries facilitate production, distribution and consumption activities.
- Linkage industries are industries which depend on each other for inputs or use of output:
 - ✓ Backward linkage industries supply inputs for production in another industry.
 - ✓ Forward linkage industries use the output of another industry as inputs.
- Promotion of industrial linkages is important as additional employment can be generated, the development of the area is enhanced and industries have easy access to inputs and ready markets for outputs.

Assessment



Assessment

This assessment has two questions which require written answers and ten multiple choice questions. You should spend thirty minutes on this assessment.

Question #1: Based on the list of production activities described in the first column of the table below, fill in the blank spaces in the other two columns. In column two, identify the type of production. In column three, identify the type of industries which operate in that type of production.

(10 marks)

Production activity	Type of production	Type of industries
Extracting of raw materials		
Converting raw materials into finished goods		
Providing transportation of raw materials and finished goods		
Using raw materials and finished goods to build a house		
Providing personal services like hairdressing		

Figure 31

Question # 2: Below you will find jumbled circles and brief descriptions of how gas is produced. (5 Marks)

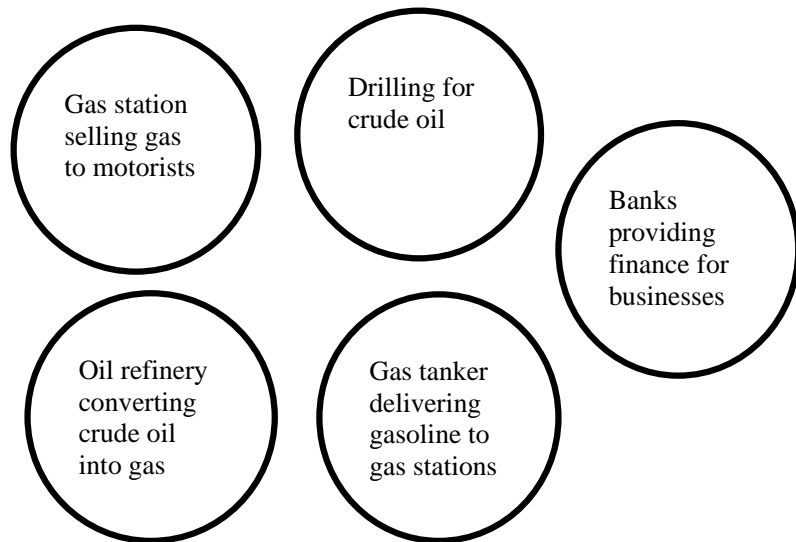


Figure 32

Write down each description under the relevant type of production in the table below.

Primary Production	Secondary Production	Tertiary Production

Figure 33

Multiple choice questions: (10 Marks)

Circle the letter which corresponds to the most appropriate answer for the following ten multiple choice questions. You will get one mark for each correct answer.

1. Which of the following is NOT a primary industry?
 - a) Fishing
 - b) Mining
 - c) Banking
 - d) Agriculture
2. If a business is converting gold into jewels to supply to a jewelry store, what type of production is it engaged in?
 - a) Primary production
 - b) Secondary production
 - c) Tertiary production
 - d) Direct production

3. Which of the following is an example of a direct service industry?
 - a) banking
 - b) advertising
 - c) warehousing
 - d) hairdressing

4. The type of industries that combine natural resources and manufactured goods to make a new product is called
 - a) primary industries.
 - b) manufacturing industries.
 - c) construction industries.
 - d) direct service industries.

5. Commercial service industries may best be described as businesses which
 - a) enable direct satisfaction of wants.
 - b) combine the factors of production.
 - c) employ a large number of people.
 - d) facilitate the production process.

6. Which of the following describe a backward linkage between two industries?
 - (a) Two industries produce the same product.
 - (b) One industry shares the use of machinery with the other industry.
 - (c) One industry develops right next to the other industry.
 - (d) The output of one industry becomes the input of the other industry.

7. Which one is NOT a feature of forward linkages among industries?
 - (a) They move a product closer to the final user.
 - (b) They use the output of the main industry as an input.
 - (c) They transport inputs where they are needed.
 - (d) They provide inputs for production to take place.
8. Which of the following is NOT a benefit of linkages among industries?
 - (a) Generation of employment
 - (b) Competition for inputs
 - (c) Easy accessibility to inputs
 - (d) Provision of markets for output
9. Mrs. Smith makes local candies and supplies them to the nearby supermarket where they are sold to customers. Which of the following describes the type of link Mrs. Smith has with the supermarket?
 - (a) Forward linkage
 - (b) Backward linkage
 - (c) Horizontal linkage
 - (d) Industrial linkage
10. Commercial service industries, which often serve as forward linkages to manufacturers, are engaged in the following type of production:
 - (a) Primary production
 - (b) Secondary production
 - (c) Tertiary production
 - (d) Large scale production

Total: 25 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Session 4: Levels of Production

Introduction

John lives alone and has a watermelon plant in his backyard which is able to meet his needs for this fruit.

Mr. Smith inherited several acres of land on which he planted watermelons. He is one of the ten large watermelon farmers who supply and sell enough to meet the total demand for this fruit in the country.

The government has recently given farmers incentives like land, seeds and money grants to encourage them to plant more watermelons. The aim is to increase production so there can be extra watermelons to sell to other countries.

The amount of goods produced can vary significantly, as shown above. In this session you will learn how the particular level of production is determined.

Upon completion of this session you will be able to:



Outcomes

Explain the three levels of production.

State the factors that determine the level of production.

Identify the benefits of each level of production.

Levels of Production

The level of production refers to the amount of output of goods and services produced. The actual classification of the level of production is based on whether or not the output meets the demand of individuals, the entire country or if there is extra for sale to other countries.

The three levels of production are:

1. Subsistence production
2. Domestic production
3. Surplus production



Discussion

Before looking at these levels of production in detail, recall the factors of production, as well as reasons why businesses undertake production. Now use this knowledge to discuss what you think will determine the amount of goods and services a business will produce. Do this with your classmates/tutor and prepare a list of your points.

You can check your list with the points identified below.

Factors that determine the level of production

1. **Access to financial capital:** The financial base of a business influences how much money it has access to. This determines how much inputs it can acquire for production. Businesses that can access more money are usually able to finance production on a larger scale than those which have limited access to finance.
2. **Access to natural resources:** The amount of land and natural resources that a business has access to, and the extent to which they are utilized, influence its level of production. You will recall that businesses can also use imported inputs for local production. Thus the ability to get raw materials that it does not have, mainly from other countries, can also impact the quantity of goods and services a business is able to produce.
3. **The labour supply:** You will recall that labour is an essential factor in the production process, so the quantity of output that can be produced will be influenced by the quantity and quality of the available labour supply. Generally, if a business has people with high skill levels and expertise, plus a positive attitude, the level of productivity and output will be high.
4. **Capital stock and level of technology:** The amount and nature of capital equipment and technology that a business has also determine its output capacity. The use of machines can speed up production and save time, resulting in larger levels of output.
5. **Risk taking of the entrepreneur:** The amount of risk an entrepreneur is willing to undertake influences the level of production. Usually businesses with skillful entrepreneurs who take greater risks and make effective decisions will have higher levels of productivity and profitability.
6. **Demand for the product:** The potential market for the good or service being produced will of course influence the level of production, as businesses will usually strive to successfully meet demand. Thus businesses that have and anticipate higher levels of demand will usually produce larger levels of output.

7. **External factors:** The economic and political climate of a country can influence business confidence and this will determine how much is invested and hence produced.

You will now examine the different levels of production.

Subsistence Production

Subsistence production occurs when just enough is made to meet only the needs of individual persons and their family. For example, a family may grow sufficient vegetables and rear some animals to meet their own requirements of these products.

You will remember from Unit 1 that in the early days of civilization people practiced subsistence production and were able to satisfy their basic needs for food, clothing and shelter by gathering materials found in their surroundings. There was no opportunity to create further wealth or to improve their present standard of living. The subsistence level of production is not very common today. However, it is still practiced, especially by individual families who grow specific fruit and vegetables to satisfy their own needs.

Domestic Production

Domestic production is where the output produced is just enough to fully meet national demand.

The emphasis of the domestic level of production is on attaining local self-reliance. Even though it may not be possible for countries to achieve domestic level of production in all goods and services, many may be self-sufficient in specific goods and services. For example, the cement industry in Trinidad is able to produce enough cement to meet local demand. The farmers in most small Caribbean islands, e.g., Barbados, Grenada and St. Vincent, are usually able to supply sufficient fruits, such as mangoes, in order to satisfy the local market.

Can you think of any good or service produced in your country that is able to meet the current local demand?



Activity

Identify the factors that explain why businesses engage in the domestic level of production.

Check the Learners Guide for the answer to this activity. If this has not been provided, you may discuss your answers with your tutor.



Reflection

What do you think are the benefits a country can enjoy if it achieves domestic level of production in a wide range of goods and services?

Compare your points with those listed below.

Benefits of domestic level of production:

1. **Employment:** When emphasis is placed on domestic production, jobs are generated for people in the country. The income they earn will help them to buy goods and services desired and even save for the future and invest. This will assist in improving the standard of living that people can enjoy.
2. **Utilizes local resources:** Domestic production utilises local resources the country possesses. This will help to promote economic growth and development. Details of this will be explored in a later session. However, care must be taken to use resources wisely to prevent over exploitation and to ensure that some are retained for the future; this is known as sustainable development.
3. **Saves foreign exchange:** When domestic production produces goods for the local market, there will be no need for a country to spend foreign exchange on importing these goods. The foreign exchange can instead be used to import capital equipment to facilitate increased local production or to buy essential goods and services that the country is unable to produce.
4. **Achieves self-sufficiency:** Generally, domestic production enables a country to achieve a certain degree of self-sufficiency and to be less dependent on others.

Surplus Production

Surplus production is where output is sufficient to meet local demand but there is extra or surplus for sale or export to other countries. For example, most Caribbean countries produce enough sugar to meet domestic needs as well as to sell to international markets.



Activity

Identify three businesses in your country which engage in surplus production. State the goods or services that each business produces and the countries to which they are exported. Use the table below for your answer.

Country: _____

Business engaged in surplus production	Goods/services produced	Countries to which goods/services are exported

Figure 35



Discussion

Discuss with your classmates/tutor why it is possible for businesses to engage in surplus production.

Compare the points raised in your discussion with those presented in the Learners Guide.

You will now focus on the benefits of engaging in surplus production.

Benefits of surplus production

Surplus level of production enables a country to enjoy all the benefits of domestic production, as well as earn foreign exchange from the products exported. The following are some of the additional benefits that can be derived from the foreign exchange that is earned:

1. **Pay for imports:** Foreign exchange that is earned can be used to pay for imported goods and services that cannot be produced locally. This will enable people to enjoy a wider variety of products and thus experience an improvement in their quality of life.
2. **Purchase capital equipment and raw materials:** A reserve of foreign exchange allows businesses to have access to the currency required for importing raw materials and capital equipment that the country does not possess. This can be used as inputs to facilitate production

locally and result in positive benefits for profitability, employment, standard of living, national output and economic growth and development for the country.

The benefits of surplus production are so great that most governments adopt deliberate policies to encourage local industries to place emphasis on export oriented production.

Session Summary



Summary

- In this session you learned that the level of production in a country depends on the quantity and quality of factors of production, as well as economic and political influences.
- The subsistence level of production results in an output of goods that meet the needs of an individual.
- The domestic level of production makes use of local resources and produces output that is sufficient to meet the local demand of people in the country. This level of production promotes self-reliance and self-sufficiency and minimizes the need to import.
- The surplus level production meets both local demand and has surplus output for export. The country is able to achieve self-sufficiency and also enjoy the added benefits of earning foreign exchange to finance importation, and thus have a wider variety of goods, services and inputs for local industries. This enhances quality of life and promotes economic growth and development within the country.

Assessment



Assessment

State whether the following statements are true or false, by circling the appropriate word. You should spend ten minutes on this assessment. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. The extent to which a country's natural resources are utilized has no effect on the amount of goods and services produced.

True / False

2. The potential market for a product influences the level of output.
True / False
3. Subsistence production was only practised in the early days of civilization when the subsistence economy existed. True / False
4. A benefit of domestic production is the country's ability to earn foreign exchange. True / False
5. Domestic production contributes to self-reliance in countries.
True / False
6. Specialisation by countries provides markets for surplus output.
True / False
7. Tax reliefs are given by governments to encourage export oriented production by local businesses. True / False
8. Surplus production does not utilize imported raw materials.
True / False
9. Surplus production helps to promote economic growth and development in countries. True / False
10. A country can earn foreign exchange from surplus production.
True / False

Total: 10 Marks

Assignment

Read the following scenario and answer the questions below. You should spend thirty minutes on this assignment.



Assignment

Your friend Susan recently inherited some money. She would like to open a business where she makes handcrafted wooden furniture. Susan has just completed a woodworking course. She hopes to use her natural artistic talent and the skills she acquired to produce unique items that will attract sales from middle income homeowners. Susan knows that you have just completed a unit on the factors, types and levels of production. She has come to you for advice on this area of business activity.

1. Outline to Susan two types of fixed and two types of working capital that will be required to start her business. In your outline, highlight why each type of capital identified is important to the production process. (10 marks)

2. Describe three roles that Susan will have to fulfill when she assumes the responsibility of being the entrepreneur of her business. (6 marks)

3. Illustrate to Susan how the furniture business will be linked to activities that are relevant to the primary, secondary and tertiary levels of production. (9 marks)

4. Susan states that in the future she would like to export some of her furniture to other countries. Explain how this move from domestic production to surplus production can be beneficial to her country. (5 marks)

Total 30 marks

When you are finished this assignment, submit it to your tutor for evaluation. You may be asked to include the session assessments you have completed and self-marked.

Unit 5: Location and Size of Businesses

Introduction

Businesses ranging in size, from the very small operating in a person's home to the gigantic multinational corporation, are prevalent throughout the world today. What do people consider when deciding where to set up a business? Why are businesses of such different sizes? Do small businesses necessarily grow into large ones?

In this unit you will apply your knowledge of the factors of production to determine reasons why businesses are located in certain areas. You will examine why businesses of different sizes exist and identify the advantages and disadvantages of each.

Upon completion of this unit you will be able to:



Investigate the factors in choosing a location for a business.

Explain what accounts for the different size of businesses.

Describe the role and function of small businesses.

Assess the impact of growth on a business.

Examine the special case of cottage industries.

Session 1: Location of Businesses

Introduction

Suppose you want to open a business. You may want to sell something that you can produce. Or you may engage in distribution, where you sell something produced by another business. Where should you set up your business? Will the required conditions be the same for businesses that are engaged in different types of production activities? If you are faced with several possible locations, what factors will influence your decision to choose a particular place?

In this session you will learn about the factors that influence decisions made for location of businesses. From the knowledge you acquire, you will be able to recommend appropriate locations for different types of businesses. This information will also be very useful when you begin the preparation of a business plan in Unit 10.

Upon completion of this session you will be able to:



Outcomes

Explain the factors that influence business location.

Recommend suitable locations for different types of businesses.

Describe how government affects business location decisions.

Time Frame: Twenty hours (20 hours)



Terminology

Incentives: Something given to motivate or encourage persons to undertake certain activities.

Tax concessions: Special reductions or relief from payment of taxes, given to act as incentives.

Industrial estate: Special areas designated and equipped with the necessary facilities for the establishment of manufacturing industries.

Department store: A very large retail establishment selling a wide range of goods in different departments.

Factors Affecting Business Location



Reflection

Think about a large department store that offers a wide range of manufactured goods for sale in your country. Identify where it is located. Make a list of points you think influenced the decision to set it up there.

You can compare your list with the suggested one below.

Most likely the department store you identified will be located on a main street in one of the cities or towns in your country. For example, in Trinidad you may have thought of “Excellent Stores” which has branches in the cities and major commercial areas of Port Of Spain, San Fernando and Chaguanas.

Reasons that influenced the decision to locate the department store at these locations would have included:

- Sufficient land was available for the construction of a large building that could accommodate many different departments.
- The location is convenient for attracting people who visit the city to walk into the store and make purchases.
- The availability of transport facilities in the city make it convenient for workers to get to and from work and for vehicles to deliver supplies to the store.
- The city has a good supply of electricity, water and an efficient communication network, as these are essential to the operation of a department store.

Now suppose you had to choose a location for an oil refinery in your country. Should it be located in busy commercial areas like the department store? Do you think any other factors should be considered? You can make adjustments to your previous list.

Hopefully you recognised that it is not practical to locate an oil refinery in the city, and that in comparison to the department store, these additional points will have to be considered:

- The oil refinery will require a lot more land than the department store.
- There is the potential danger an oil refinery may pose to people and the environment because of pollution and the potential risks inherent in the production process.
- The choice of location of the oil refinery will require a sufficient amount of land that is a safe distance away from populated areas.
- An oil refinery that is heavily dependent on imports of crude oil and exports of the refined products should be located near a sea port. This will save time and reduce transport cost of these bulky products.

However, like the department store, an oil refinery must be near to an effective transportation network to enable workers to get to and from work easily and for delivery of inputs and output. Also, the access to adequate supplies of electricity, water and communication services will be important for the oil refinery.

Do you have any additional points? You can discuss them with your class. You will realise that there are some common factors that need to be considered when choosing a business location, no matter what type of business. However, some businesses may have special requirements because of their unique nature.

Finding the ideal location for a business is an important decision. Sometimes a suitable place may not be available and choices may be limited. The task then becomes one of making the best of what is available to derive maximum benefits in the most cost efficient way.

Let us now examine the factors that affect business location in greater detail.

Factors that influence the location of businesses

1. **Availability of land:** In Session 1 of Unit 3 you learnt that land provides natural resources for production and also facilitates the construction of buildings. Finding the right type of land in the right amounts and in the right place is essential in locating a business.

The amount and type of land needed will depend on the nature of the business. Some large firms producing products like gasoline, iron, steel, chemicals and cement require huge expanses of land that are not very near to populated areas. This is because of the extensive amount of capital equipment needed and the pollution

generated during the production process. Small and medium sized firms will need less land space. However, all businesses should try to acquire enough land to cater for possible future expansion.

Another aspect of land that needs to be considered is its physical features. The slope and fertility of land, and even weather conditions, can influence the location of some businesses, especially those involved in agriculture. Also, in the tourism industry, hotels wishing to market “Sand, Sun and Surf” will need to be located near sunny waterfronts; while on the other extreme ski lodges will need mountainous, snowy locations.

Businesses engaged in commercial services generally tend to require less land than manufacturing businesses. This, of course, depends on the size of the operations. It is very common for small retail businesses like shops and vendors’ stalls to be located on little land space but in areas which are convenient to customers. Some of these locations are in towns, cities, villages and sometimes even in or outside people’s homes. A recent trend is for large shopping complexes and malls to be located on the outskirts of busy cities where there is more land space for the buildings and car parks and less traffic congestion.

2. **Accessibility to raw materials and other inputs:** Close and easy access to raw materials and manufactured inputs can save time and transportation costs for businesses. Businesses which require large amounts of heavy, bulky raw materials should aim to locate near sources of supply or, if they are relying on imported materials, near ports of entry. For example, the oil refinery in Trinidad is located at the port of Pointe-a-Pierre to accommodate the huge tanker ships that transport crude oil for refining. Also, the cement factory at Claxton Bay in Trinidad has a conveyor belt that runs from the factory straight to the seaport; this allows cement to be loaded directly to the ships for export.

Businesses involved in selling final products should have easy, reliable and relatively cheap access to their supplies. For example, newspapers should be available early, every morning, regardless of where they are printed. Farm produce must be fresh and available at the vendors’ outlets even though farms may be hundreds of miles away. The main concern here is not necessarily nearness but the business having access to the required transportation network to get what is needed in a timely and cost effective way.

In our contemporary business environment, this issue of proximity versus accessibility is a critical one. Advancements in technology, transportation and communication now facilitate easy accessibility to almost anything a business needs. Thus nearness to supplies of raw materials and products, and even to potential

customers, is not as essential as being able to have access to them. At the touch of a button, a business can use the internet to order raw materials or goods from any country in the world. Timely deliveries of these are facilitated by fast and efficient forms of transportation by land, sea or air. Even payment is simple and easy through the use of electronic money transfers. These developments have contributed to the world now being described as a global village, in which people all over the world have ready access and opportunities to trade with each other.

3. **Availability of labour:** Recall that in Unit 3 you learnt that production is impossible without the input of labour. Business activity would grind to a halt or be inefficient without access to the required amount and type of labour needed. The location of many businesses has been influenced by the presence of available, reasonably priced labour. Thus businesses should be located in areas where workers can have trouble free access to and from their homes and workplace. Again the emphasis here is on accessibility and not necessarily nearness. With improvements in transportation, distance is now second place to convenient and reliable accessibility.
4. **Adequate infrastructure:** Infrastructure refers to the facilities that provide a transportation network, telecommunications services, water and power supplies in a country. Usually these are public goods as they are provided by the government.

An adequate and efficient infrastructure is an important consideration when deciding on business location. As mentioned previously, raw materials, finished products and labour require access to and from businesses. This can only be facilitated with a transportation network that allows land, air and sea travel. When choosing a location for businesses, it is essential to consider whether these are available or if they will become available in the near future.

An efficient telecommunications network is also important. In our modern day global village, many business transactions are done electronically so the speed, reliability and availability of telecommunications can influence business location.

Can any business you know operate efficiently without power and water? Easy access to adequate and dependable sources of power and water are an important consideration in business location.

Many countries have specifically designated areas for industrial businesses on what are commonly called industrial estates. These industrial estates are properly equipped with the necessary infrastructure and located in that take advantage of the factors which positively influence the location of industries.

5. **Accessibility to markets/customers:** Output must reach its customers for the production process to be complete. Many businesses rely on “walk-in” customers for a high sales turnover, e.g. clothing and fast food retail outlets, commercial banks and direct service businesses such as hairdressers. As a result, these businesses tend to be located in busy cities, towns and other commercial areas. However, competition for the limited land space in towns and cities has resulted in the development of large shopping malls and plazas on the outskirts of cities but near residential areas and customers. As mentioned previously, these locations are ideal because there is sufficient land to accommodate many stores and large car parks for customers, in addition to have adequate infrastructure facilities.

In our contemporary business environment, some businesses engaged in distribution of goods are relying less on strategically placed showrooms to attract sales. The use of e-commerce now allows advertising and trade transactions to take place electronically and deliveries be made directly to the buyer’s address. These businesses only require large warehouses to store goods, and these can be located where there is affordable and sufficient space.

Manufacturing businesses like factories, which require a lot more land space, do not necessarily have to be located near customers as most of the commercial and direct service businesses do. What is important is easy access to facilitate delivery of products to both local and international buyers who usually purchase in bulk or very large quantities.



Activity

Examine the following pictures and for each one, identify two factors which you think are responsible for the location of the businesses shown. You can use the table provided. In the first column, write the name of the business and in the second column, write the two reasons for its location.



Figure 1: Cement Factory by [Joe Mabel](#) Source: [http://upload.wikimedia.org/wikipedia/commons/a/a7/Ash Grove Cement factory_01.jpg](http://upload.wikimedia.org/wikipedia/commons/a/a7/Ash_Grove_Cement_factory_01.jpg)



Figure 2: An Oil Refinery by [azza-bazoo](#) Source: http://farm2.static.flickr.com/1020/531780382_d52efcb108.jpg



Figure 3: Retail stores in a shopping plaza photo by [Infrogmation](#) Source: <http://wikimediafoundation.org/wiki/File:MetairieShoppingCenterCansecos.JPG>



Figure 4: A popular holiday beach resort in the Caribbean by [Grand Velas Riviera Maya](http://www.flickr.com/photos/grandvelasrivieramaya/3180227438/) Source: <http://www.flickr.com/photos/grandvelasrivieramaya/3180227438/>

Name of Business	Reasons for location of business

How Government Influences Location of Businesses

In most countries, the government may adopt policies that affect the location of industries, all in its attempt to achieve economic growth and development while ensuring the collective welfare of citizens. Basically, these policies can be divided into two categories: regulations and assistance.

1. Government regulations that affect business location.
 - i. **Licence to operate:** There are many laws and regulations that govern the establishment and operation of business organisations. You may recall that you were introduced to some of these in Unit 2. Usually, government approval is required before a business can begin operations. Thus the granting of the necessary licence or legal permission to operate will determine whether or not a business can be set up in a country.
 - ii. **Approval for land use:** Businesses also require approval for land use and this directly influences their location. For example, laws prohibit the setting up of businesses in residential areas. Industries which emit harmful pollutants and can pose a threat to people, flora and fauna are required to be located in specially designated areas for which the environmental authority gives approval.

2. Government assistance and business location.
 - i. **Incentives to locate in certain areas:** In its overall planning, a government may encourage the location of businesses in certain areas. For example, if there is unemployment and under-development in certain parts of the country and the government wishes to promote a more balanced development, then special incentives will be offered to encourage persons to invest in businesses there. These incentives may include tax relief, financial assistance, training and advice, together with the provision of the infrastructure that is needed.
 - ii. **Incentives to foreign investors:** Many governments, especially in developing and under-developed countries, often offer foreign investors and multinational corporations special incentives to encourage them to set up in local economies. You can refer to Unit 3 Session 3 to review the advantages that multinational companies bring to host countries to understand why this is done.
 - iii. **Establishment of industrial estates:** Sometimes governments may totally finance or assist the private sector in the establishment of industrial estates. This is done to encourage businesses to locate in these specific

areas, which are equipped with the required infrastructure.



Activity

You will use the scrapbook which you started in Unit 1 for this activity. Choose one of the businesses you identified. Start a new section in the scrapbook entitled “Location of (insert the name of the business)”. State where this business is located and explain five factors which you think influenced its owners to locate the business there.

Session Summary



Summary

In this session you learnt that finding the right location for a business is an important decision. The desire to minimise costs, save time and achieve efficiency are some of the main considerations. The points listed below are a review of the main factors that influence the location of businesses:

- Availability of the right type of land in the right amount and in the right place.
- Close and easy access to raw materials required for production or to sources of goods and services to be distributed.
- The presence of available, reasonably priced labour with the necessary skills for the business.
- An efficient infrastructure system providing adequate transport, communication, water and power services.
- Easy access to markets both locally and internationally to ensure convenience for customers.
- Government regulations and assistance.

Assessment



Assessment

This assessment has one structured question with three parts. You should spend thirty minutes on this question. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

You have been asked to advise a group of investors on where the three businesses described below should be located in your country.

The businesses are:

1. A steel smelter plant that will use a significant amount of imported raw materials and export a large portion of its output. (5 Marks)

2. A shopping mall that will have one hundred retail outlets and over two thousand customers on a daily basis. (5 Marks)

3. A small variety shop selling candies, sandwiches, newspapers and stationery items. (5 Marks)

For each business, recommend a suitable location and explain three main factors that influenced your decision.

Total: 15 marks

Session 2: Small Businesses

Introduction

Do you think all businesses started off at their present size? Try to identify two businesses you are familiar with that are involved in the same type of production – choose one you consider to be small and one that you consider to be large. Why do think each one continues to exist? Why do both of them continue to exist even though they are providing the same good or service?

In this session you will be able to identify why businesses are small in order to appreciate their importance in the economy and to recognise why they continue to develop and survive even in the presence of larger businesses.

Upon completion of this session you will be able to:



Outcomes

Identify the criteria used to classify a business as small.

State reasons why businesses are small.

Explain the importance of small businesses.

Identify problems faced by small businesses.

Explain why small businesses continue to exist.



Terminology

Market share:	The proportion of total sales of a good or service that each firm in an industry has.
Assets:	The material goods and resources a business owns. This includes fixed capital, such as the buildings or plant, machinery and vehicles, as well as working capital, such as stock and cash.
Plant capacity:	The maximum amount of goods a business can produce with its given amounts of fixed capital.
Capital intensive production:	The production process uses more machines, equipment and technology than human labour.
Labour intensive production:	The production process uses more human labour than machines, equipment and technology.

What is a Small Business?

The definition of something being small is a relative concept. This means that to decide whether something is small it must be compared with something else. Thus what might be small for one person might be classified as large for another. There are many definitions and interpretations of “small” in the world of business. In some countries, the government sets the criteria to classify businesses into different sizes.

For example Trinidad and Tobago presently uses the following criteria to classify small business:

Employment	Value of Assets	Value of annual Sales
1– 25	Up to \$250 000	Up to \$250 000

Figure 5

For the purposes of this lesson, the above criteria will be used as guidelines to define a small business.

1. **The value of assets:** If the value of assets used to start up the business is the amount specified by the country under consideration, then in that country the business will be classified as small. Special mention is being made with respect to countries as different ones have different money limits for defining small businesses.

For example, in Trinidad and Tobago the maximum limit of assets for a business to be called small is two hundred and fifty thousand dollars of local currency. You may be able to recognise the problems with this, as the value of money changes when prices change. In addition, the comparative value of currencies among countries is different.

Generally, in terms of fixed assets, the amount of plant and equipment used in a business may vary. A small business engaged in the same type of production as a larger one will basically have less machinery, buildings and equipment and hence a lower level of plant capacity. For example, consider the assets a person sewing clothes at home will have and compare this with what a large established garment factory will possess.

Please note that this is a generalisation and only one of the factors considered in attempting to classify a business by size. The nature of the business operation will determine the different degrees of requirements for plant and equipment.

2. **Number of persons employed:** Again, different countries may have their own maximum number of employees to determine the size of businesses. Using the standards of Trinidad and Tobago, a small business may range from one employee to as many as twenty five. However, one has to be careful with this standard as some businesses may be large but employ relatively fewer people because of its capital intensive operations. This means it uses more machines than labour, for example, the assembling of cars. Conversely, a business may be small and labour intensive. This means that it employs more people and uses less machinery, for example, the operation of a small guest house.
3. **Sales value:** Sales value refers to the monetary worth of goods and services sold. Again, there are maximum limits in different countries. However, this value may depend on the cost of the product being sold. For example, a business may be selling a product that has a high price, such as computers. Compare this with a business selling calculators, which have a lower price. Many more calculators will have to be sold to match the sales value of fewer computers. However, the maximum sales value is usually set by the government and is used primarily to determine whether or not a business will be exempted from paying certain taxes.
4. **Market share:** Market share refers to the portion or percent of total sales each business in a particular industry has. This can be used in a relative context in an attempt to determine which business qualifies as small. For example, if in a three firm industry, Firm A has 10 percent of market share, B has 40 percent and C has the remaining 50 percent, then one can safely conclude that relatively speaking A is a small business.

It is evident that defining a business as small is not a straightforward task, so comparisons have to be made. Looking around your community and country for examples may also assist you. The roadside vendor selling produce from his backyard garden is obviously small when compared with a farmer who has many acres of land and sells the produce wholesale to market vendors, supermarkets and restaurants. Consider also people operating from their homes to produce preserves, garments or furniture. They are obviously smaller business operations than specially designed factories with modern machinery and technology.

Why Are Businesses Small?

Reasons why some businesses remain small

1. **Limited access to capital:** All businesses need financial capital in order to acquire the necessary inputs for their operations. Many businesses start off small because the entrepreneurs did not have sufficient capital to launch operations on a larger scale. If in the future the business is unable to acquire additional capital to finance expansion or diversification, then it will remain small.
2. **There is a small market:** The underlying aim of all privately owned businesses is to make a profit by supplying a good or service that people want and are willing to pay for. Sometimes the market that a business is catering for may be small. Reasons for this may be that there is not a high demand for the product or the business is located in an area with a small population and thus a small target market. As a result, the business will remain small to avoid overproduction and any subsequent losses.
3. **It is the size with which the entrepreneur is comfortable:** People establish businesses for many different reasons. If a business is small because that is the maximum amount of invested capital that the owner is willing to risk, then the firm will remain small. Sometimes an entrepreneur might conclude that a larger business may require more responsibility and time so he may keep the business small to allow him to balance his work, time and leisure.

Importance of Small Businesses

The prevalence of small businesses in all countries is proof of their importance.



Reflection

Look around you and identify some small businesses in your community. Are they serving useful functions? Would your community be the same without these businesses?

The importance of small businesses arises because of the following valuable functions they perform.

Functions of small businesses

1. **Small businesses often provide personalised and unique goods and services.** The person(s) operating small businesses tend to have a closer and more direct link with customers and can provide the

personal touch that larger firms cannot give to its wider customer base.

For example, a small dressmaker will design and sew exclusive dresses for each customer, compared to the standard mass produced dresses often sold by large garment factories. Also, some small business owners are so familiar with their customers that they give them credit. This means they allow them to take goods and pay for them at a later date. In large businesses, credit facilities are only extended to certain persons and mainly within the legal framework of hire purchase agreements. Hire purchase agreements will be discussed in Unit 12.

2. **Small businesses contribute to employment:** Although small businesses employ a few people individually, when viewed collectively they make a significant contribution to employment in a country. They are also an important form of self-employment and a source of additional income.
3. **Small businesses can serve as healthy competition for larger businesses:** Many small businesses tend to be located in villages, towns and in close proximity to residential areas. These convenient locations assure them of sales and enable them to compete successfully with larger firms. The personalised services offered by many small businesses give them an advantage over larger ones. This competition serves as an incentive for larger businesses to offer good quality goods and services since customers will otherwise go to smaller businesses.
4. **Small businesses often fill specialised or niche markets:** Sometimes there may be a limited demand for a special service, for example, twenty-four hour babysitting in emergencies or pet sitting when people go away on vacations. Small businesses are best suited to cater for these specialised areas where demand is not very regular or large.
5. **Small businesses often serve as linkages to firms and industries:** You will recall that you learnt about industrial linkages in Unit 4. Many small businesses provide essential goods or services that are needed as inputs for production in other businesses. For example, a small farmer can supply a large restaurant with peppers from his garden because this is a product that is not needed on a large scale but is essential in the preparation of some meals.
A strategy that many larger businesses are using to minimise the number of people they have to employ permanently is contracting out certain jobs to small firms. For example, instead of hiring full-time maintenance staff, they are leasing these jobs to small businesses that can provide the services on a part-time basis. This helps these small businesses to thrive.
6. **Small businesses are potential future large businesses:** Small trees, more often than not, grow into big trees. This comparison can be applied in the business world. Many of our present day large

businesses once started off small. Thus small businesses, apart from fulfilling all the important roles outlined above, are potential future large businesses.

In the next session you will explore how small businesses can grow into larger enterprises. The pictures below show some examples of small businesses.



A Small Bakery

Source:

http://farm1.static.flickr.com/111/290467645_c4807ebea1_o.jpg



Nail Technician: photo by Wrenel Roberts

Source: Stock file Distance Education Unit

Figure 6



Activity

This activity requires the use of the scrapbook you started in Unit 1. Start a new page entitled ‘The importance of small businesses’. Identify one example of a small business you have in your book. State two reasons why you think it remains small. Outline three important functions that the business provides.

Problems Faced by Small Businesses

Even though small businesses are so widespread, many face problems and challenges. However, those that continue to survive have people who view the challenges as opportunities and take measures to solve or minimise drawbacks. Let us now examine some common problems small businesses face and try to suggest possible solutions.

1. **Insufficient financial capital:** A major problem faced by small businesses, and one that keeps them small, is insufficient financial capital. Most small business owners find it difficult to obtain loans

from financial institutions, and are thus unable to make desired improvements in their business. The main reason for this is the fact that they may not possess enough assets to act as security for loans. Also, their small sales value may make lending to them very risky.



Reflection

Imagine the small nuts vendor from your neighbourhood going to the bank for a loan, compared to the owner of a large nearby restaurant. Who do you think will have a greater chance of getting a larger loan with easier terms of repayment?

What would you recommend to the small business to overcome this problem of insufficient financial capital?

A possible source of additional capital for a small business may be to change the form of the business organisation. You can recall the various forms of business organisations from Unit 3. Usually small businesses tend to be the sole trader form of business, with one owner who has responsibility for supplying all the capital. If the business is converted to a partnership, co-operative or limited company, it will have the option of getting shareholders who can buy shares and raise the amount of capital needed. However, to do this the entrepreneur must be willing to relinquish sole ownership of the business.

To ensure that there is sufficient financial capital for future plans and expansion, owners of businesses can retain a greater percent of profits earned. This can be saved as a special fund to ensure that the business can have access to its own money when needed, thus reducing the need to borrow or acquire additional shareholders. This sacrifice of taking less profit for personal use and ploughing back more into the business will eventually help owners of small businesses to deal with the challenge of insufficient financial capital.

2. **Limited and inefficient management:** Some small businesses face the problem of limited and inefficient management. This often arises when the person who sets up and runs the business does not possess any formal business training or practical experience.

This is a very easy obstacle to overcome as long as the owner is committed to acquiring the necessary formal training. Many governments and private institutions offer courses that can equip anyone with the knowledge and skills required for effective business management. Remember the qualities of a successful entrepreneur that were identified in Unit 3 Session 2? Review these to see how the challenge of inefficient management can also be addressed.

3. **Competition from larger businesses:** Competition from larger businesses can be a threat to most small businesses. In the next session, you will learn of the advantages that large businesses have and get a better idea of what small businesses are up against. However, let us highlight a few of the challenges small businesses have to overcome.

Large businesses have access to more resources and can enjoy advantages like lower unit costs and selling prices which small businesses cannot offer because of their limited resource base. They also have a wider customer base which may be both local and international, while the small businesses often only service the local community. However, the fact that large businesses tend to dominate the market should not daunt small businesses. To compete successfully, small businesses need to highlight their strong points in order to survive and prosper. They need to offer the highest product quality and service to earn a reputation that will guarantee an increase in customers.

In reality, not everyone who pursues an idea and establishes a business will be successful. However, this is true for businesses of any size. Even though the extent of business failure may be relatively higher for smaller businesses because of the problems identified above, remember those that continue to survive have people who view the challenges as opportunities and take measures to solve or minimise drawbacks.

Let us now examine why small businesses can exist alongside and compete successfully with larger ones.

Why Small Businesses Survive Alongside Large Businesses

You can go to supermarket and buy a loaf of bread that was mass produced in a large bakery and distributed nationwide. Or you can go to the neighbourhood home-style cafe where the owner makes her own bread and sells it for a slightly higher price than the supermarket, but still gets sales. Why do both businesses have customers who want to buy their bread? How can these two businesses of different sizes exist even though they are providing a similar product?

Some reasons for the continued existence of small firms even in the face of competition from large firms include the following points:

1. **Conveniently open for longer hours:** Many small businesses are conveniently open for longer hours than large ones. This is so because the owner often resides at the same location and therefore he/she can afford to keep it open. He/she does not have to employ many workers who work for specific time schedules like large businesses do. This extra time that customers have to access products

in small businesses is an advantage that contributes to their continued existence.

2. **Perform additional services:** Many small businesses provide additional services that larger businesses do not offer. As mentioned earlier in this lesson, usually the owner of the business personally knows most of the customers so they are granted short periods of credit, for example, the customer may be allowed to buy essential food items for his family and pay when he receives his wages a few days later. Delivering goods to the homes of customers is also a service that small businesses may offer and larger ones may not.
3. **Produce unique products:** The personalised and unique goods or services that many small businesses offer in a “homely” and friendly atmosphere is valued by some customers in preference to the anonymity and standardised products of many larger businesses. This helps to explain why both sizes of businesses continue to exist.
4. **Receive assistance from the government:** Many governments provide assistance and give incentives to encourage the establishment of small business and to ensure their continued existence. These incentives include loans, subsidies, advice and training. Most governments view assistance to small businesses as a priority because of the many benefits they confer on individuals, communities and the country. Government support goes a long way in enabling many small businesses to overcome some of their challenges and to survive alongside larger businesses.

Despite their challenges, scores of small businesses continue to survive once entrepreneurs take determined and proactive measures to be cost effective and maintain competitiveness. Small businesses continue to increase in numbers as people pursue their business ideas and gain financial independence. Many small businesses survive alongside larger businesses primarily because of their importance to their communities and the support they often receive from governments. Some are even so successful that they eventually grow into larger businesses.

Session Summary



Summary

In this session you learnt why some businesses are small. You examined the importance of small businesses and were able to appreciate why they continue to exist despite the challenges that they face. You can use the checklist below to reinforce the main points of the lesson.

- The criteria used for defining a small business are:
 - ✓ Value of assets
 - ✓ Number of persons employed
 - ✓ Sales value
 - ✓ Market share

- Businesses are small because :
 - ✓ There is limited access to capital so expansion or diversification cannot be financed.
 - ✓ There is a small market demand for goods or services so it is not feasible to operate on a larger scale.
 - ✓ The small size reflects the amount of risk the entrepreneur is willing to undertake and is the one he/she is comfortable with.

- Some of the challenges which small businesses face include:
 - ✓ Competition from large firms which have more experience and resources, lower unit costs and an established customer base.
 - ✓ Inexperienced management as the person who sets up and runs the business usually does not possess any formal business training.
 - ✓ Difficulty in accessing additional capital because of limited security to qualify for loans.

- Small business continue to exist and are important because:
 - ✓ They often provide personalised and unique goods and services and many customers value this so there is a ready market.
 - ✓ Small businesses often fill specialised or niche markets and provide additional options and choices for consumers.
 - ✓ Small businesses are often conveniently open for longer hours and provide additional services that larger businesses do not, e.g. credit and delivery.
 - ✓ Collectively, small businesses make a significant contribution to employment in a country.

- ✓ Many governments provide assistance and give incentives to encourage the establishment of small business and to guarantee their continued existence.

Assessment



Assessment

Read the article below and answer the questions which follow. You should spend twenty minutes on this assessment.

Article:

Three years ago Jane quit her job as a sales representative at a large department store and opened a small retail business selling a variety of goods, such as pre-packaged food items, household articles, newspapers and stationery supplies. People in the nearby neighbourhood are regular customers who are allowed to call Jane any time they wish to make a purchase, even if the business is closed. Jane also allows them to take goods and pay for them at a later date when they have money available.

Recently, a large supermarket was established in the area with opening hours from 8 a.m to 4 p.m. This business offers a similar range of goods and even sells some items at lower prices. However, Jane has not complained about any significant losses in sales and her business continues to be successful. She is planning to diversify her range of products and to introduce a new line of homemade pastries and cakes. Jane has excellent cooking skills and many of her customers have indicated that they will buy her pastries and cakes on a regular basis as soon as she begins to make them. However, she does not have the sufficient finances for the additional equipment and fixtures required for this diversification venture.

Now answer the questions below:

- (a) Explain three reasons why Jane's small business continues to survive even though there is a large supermarket nearby offering similar products for sale. (6 marks)
- (b) Advise Jane on two steps she can take to be able to finance her diversification venture. (4 marks)

Total: 10 marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Session 3: Growth of Businesses

Introduction

“All big trees were once small trees.” Do you agree with this statement? Do you think that this statement can be applied to businesses? Were all large businesses once small? If you answered no to the last question, you are correct. Some people may undertake huge risks and establish large businesses. However, many of our present day large businesses once started off small and grew into their present large size.

In this session you will examine how and why businesses grow. You will also consider the effects that growth may have on certain identified aspects of businesses. You will examine some challenges that large businesses face and suggest possible strategies for effectively overcoming them.

Upon completion of this unit you will be able to:



Outcomes

Explain why and how businesses grow.

Discuss the effects of business growth on its organisational structure.

Explain how growth affects the capital and labour needs of a business.

State how the scale of production and use of technology are affected by business growth.

State how business growth impacts the potential for export.

Discuss challenges that large businesses may face.



Terminology

Organisational structure:

The structure is the way in which a business is divided into sections or departments, and the positions and reporting relationships among all persons in the organisation.

Plant capacity:

The maximum amount that a firm can produce with its given fixed capital and technology.

Conglomerate:	A very large business organisation with ownership of firms engaged in a wide variety of different industries.
Economies of scale:	Reductions in costs that a business derives as a result of being large.
Unit costs:	Cost per unit of output, also called average cost. This is calculated by dividing Total Cost of Production by the Quantity of output produced.

Why Businesses Grow

Very few things remain constant. Many of the large businesses which exist today were once small. Businesses usually grow and increase the size of their operations due to many reasons.

Reasons for growth of businesses

1. **An increase in demand:** If consumers are willing and able to buy more goods and services but the present plant capacity is inadequate to meet this, a business may decide to increase its scale of production. Or, if a business is engaged in the distribution of manufactured goods, an increase in demand will serve as an incentive to expand the present business premises or open new branches or outlets.



Reflection

Identify some examples of businesses that have grown due to an increase in demand for their products.

One of the first examples that may have come to your mind is the electronics industry. The widespread ownership and use of computers, iPods and cell phones could have only been made possible if the businesses that manufacture them increased their plant capacity to produce more.

Another example of a business that has experienced rapid growth is the fast food industry. Think about the world wide increase in the number of outlets like KFC, Burger King and Pizza Hut. This growth is primarily due to the increase in demand for these products.

2. **To diversify and expand its existing product range:** Sometimes a business may wish to diversify and expand by adding new products to its existing product range. This requires additional investment to acquire the necessary resources and will result in an increase in the size of business.

For example, a firm producing soap may wish to diversify its product range to include toothpaste, shampoo and cosmetics. Another example of business expansion and diversification is the telecommunications industry in Trinidad and Tobago. At its inception, Telecommunications Services of Trinidad and Tobago (TSTT) offered only landline telephone services. Today this business has increased in size and diversified its operations, and now offers mobile phone, internet, electronic security for buildings and cable television services.

3. **To venture into new markets:** Sometimes an entrepreneur or the owners of a business may be willing to undertake additional risk and venture into new markets. To achieve this it may be necessary to expand the plant size for increased production.

For example, a business that was engaged in domestic production and selling only to the local market may decide to expand operations to surplus production to sell to foreign markets. This decision to take extra risk and venture into new markets is one of the main reasons why we have the opportunity to buy such a wide range of goods and services that are not produced in our country but are sold here. Businesses engaged in distribution also venture into new markets and set up outlets in different countries. For example, traditionally the warehouse club type shopping offered by Pricemart Limited has been based in the United States. However, this business has extended operations to Central America and the Caribbean in countries like Trinidad, Barbados, Puerto Rico.

With advancements in transportation and communication, the world is now a global market and many businesses are taking advantage of the opportunity to obtain more orders for goods and services through the use of internet and e-commerce. This requires businesses to expand and upgrade operations in order to meet these local and international orders.

How Businesses Grow

When a business makes a decision to increase its size, there are two main options available for achieving this. Growth can be attained internally or externally. Let us examine each option that a business has.

Types of business growth

1. **Internal growth of businesses:** Internal growth is achieved when a business expands within its existing structure. For example, size of operations at the present location may be increased or the business may set up new branches at other locations. This growth can be financed by using one or any combination of the following sources:
 - i Retained or “ploughed back” profits of the business.
 - ii Loans from financial institutions.
 - iii Inviting new and existing shareholders to purchase shares.
 - iv Changing the form of the business organisation to one that will have more owners to contribute share capital, for example, converting from a sole trader to a private limited company. You can recall from Unit 3 how this can be done.
2. **External growth of businesses:** The external growth of a business is achieved through integration with other businesses to form a larger organisation.

External growth through integration can be achieved through a takeover or a merger with other businesses. You will now briefly look at the difference between a takeover and a merger before examining the types of integration.

A takeover: This is a situation that businesses do not mutually agree to. The firm that is attempting a takeover is called a “predator” and its “target” is the firm it wishes to take over. The predator firm tries to gain at least a 51% share ownership in the target firm. This can be done by offering to buy shares from shareholders in the target company at a price that is higher than what they are being sold for on the stock exchange. If the predator is successful in acquiring sufficient shares, it then has the power to take over the target firm. This action results in the formation of a larger business organisation.

A merger: This occurs when businesses voluntarily and mutually agree to join and form a new larger organisation. Negotiations are conducted between both parties until a mutual agreement is reached and the businesses are integrated.

Types of integration

There are three types of integration and the one chosen will depend on the ultimate goals of the businesses involved. The three types of integration are:

- i **Horizontal integration:** This occurs when businesses which join are at the same stage of production. These businesses are usually firms which belong to the same industry.

For example, in the oil industry, horizontal integration at the primary stage of production will occur if an oil drilling company joins with another one; at the secondary stage of production, two or more oil refineries may integrate; at the tertiary stage of production, a gas station retail outlet may acquire ownership of other gas stations.

The benefits of horizontal integration include the following:

- ✓ Increased fixed capital as the new organisation now owns the buildings equipment and machinery of all the firms. This will enable the business to have a larger plant capacity and enjoy economies of scale. This will be explained in the next section of this session.
- ✓ Increased market power and market share as the integrated firm now enjoys a combined and greater demand for its products.
- ✓ Integration can also eliminate rivals as the firms that were once competitors are now under single ownership.

- ii **Vertical integration:** This occurs when businesses which join are at different stages of production in the same industry. Vertical integration can be forward or backward depending on the stage of production of the firms that are being integrated.

Let us continue the example of an oil industry to illustrate backward and forward vertical integration:

Backward vertical integration occurs when one firm joins with another that is involved in an earlier stage of production or an upstream business. For example, if the oil refinery acquires ownership of businesses that own oil fields and are engaged in drilling for oil.

Forward vertical integration occurs when the business acquires ownership of one at a later stage of production or what is commonly called a downstream business. For example, the oil drilling company acquiring ownership of the oil refinery, or the oil refinery integrating with gas stations which sell its output.

The benefits of vertical integration include:

- ✓ A larger business with a more varied range of production stages.
 - ✓ Backward integration with suppliers or upstream businesses provides a guaranteed source of inputs or supplies.
 - ✓ Forward integration with distributors of output provides a guaranteed market outlet for products.
 - ✓ Links with firms at the different stages of production give a business greater control over more operations and minimise costs of production.
- iii **Conglomerate integration:** This occurs when a business acquires others in unrelated types and/or stages of production to form common ownership. This decision may be made because the owners of the business simply have an interest in venturing into new areas, wishing to diversify their range of investments and spread risks over a wider variety of goods and services.
- For example, the owners of a business in the oil industry may acquire firms in any industry unrelated to oil, such as electronics, transport, and food production.



Activity

Imagine that you have to advise the owner of a fast food restaurant on integration as a method of increasing the size of his/her business. Using examples relevant to the business, explain to him/her the difference between horizontal and vertical integration. Point out one advantage the business will enjoy from each type of integration. Write your answer in the lines provided below.

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You can check your answer with the one provided in the Learners Guide. If this has not been provided, you may discuss your answer with your tutor.

Impact of Growth on Businesses

In the last section we examined how a business can grow in both size and diversity. Business growth will, of course, impact how a business operates and require adjustments and modifications. This section will

examine the effect that growth has on specific aspects of a business. These aspects are:

- Organisational structure
- Capital
- Labour
- Scale of production
- Technology
- Potential for export

i. Organisational structure: An organisational structure shows the way in which a business is divided into sections or departments plus the positions and reporting relationships among all persons in the organisation. You will learn more about organisational structures in Unit 6. Usually when a business grows internally it may need to employ more persons. With integration, the combination of staff will result in additional people becoming part of a single organisation. As the workforce grows, the complexity of the business increases and the possible effects on the organisational structure may include the following:

- The organisational structure can become wider with the establishment of new functional departments. Each functional department has specific duties and responsibilities for particular areas of the business. For example, a larger business may now need a specialised Human Resource department that did not exist originally. This department will deal with all the issues that arise from the increased number of workers now employed at the business.
- The organisational structure can become taller. The larger labour force employed may need greater supervision. The top level management team may have to delegate authority to people at lower levels. This will create new middle management and supervisory positions and the result will be additional levels in the hierarchical organisational structure.
- The span of control can increase. When additional persons are employed in departments, then a superior will have to oversee a greater number of subordinates. This increase in the span of control also means that more people will be accountable to the immediate superior of the department.

These changes make the organisational structure more complex and will impact the communication within the business. It is therefore essential that special attention be placed on keeping communication channels clear and effective to avoid potential problems. Two organisational structures are shown below. You will notice how complex the structure gets as a business grows larger.

Here is an example of a simple organisation chart for a small one-person retail business. Each of the three functions shown can be done by one person only.

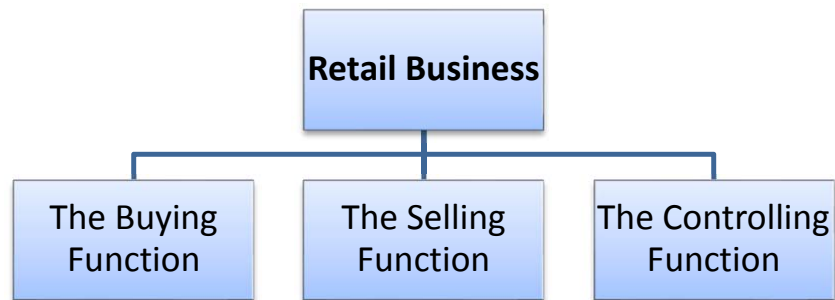


Figure 7: Simple organisation chart

Next is an example of the organisational structure for a large business. You will notice that many more departments and people are needed. The organisational structure has now become wider, taller and more complex.

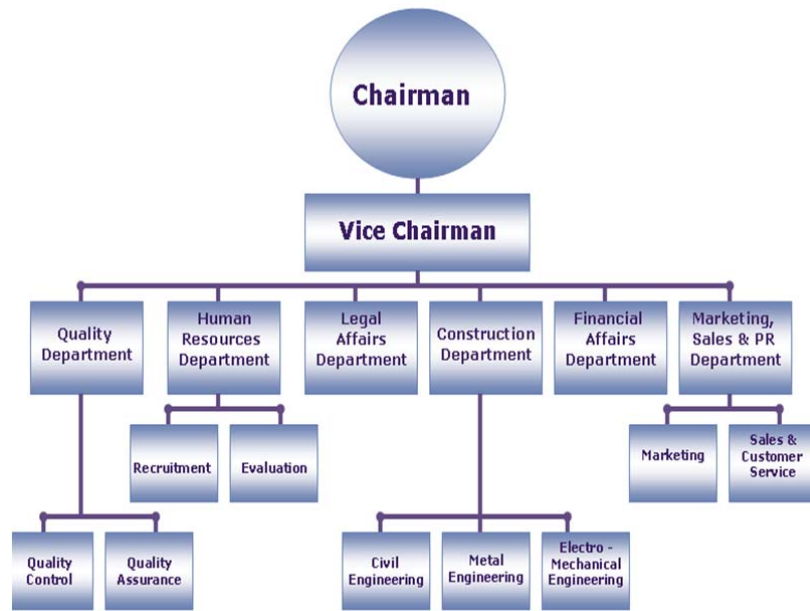


Figure 8

- ii. **Capital:** Internal growth of a business generally requires additional fixed and working capital in order to produce a larger output. The firm may have to purchase new fixed capital, such as buildings, machinery and equipment, to increase plant capacity. This will make greater demands for financial capital. Please review the sources of capital for a business from Unit 4 Session 1.

When growth is achieved through a merger or takeover, the fixed capital of both firms will result in a much larger stock of capital for the new single organisation. Usually this should be enough to meet the requirements of the business with respect to plant capacity. However, it is important to consider the impact that this additional capital can have on the quantity of labour used in the business. If the machinery is labour saving and people are in danger of being replaced by them, this can cause labour problems. It is important for management to take proactive measures to address this issue.

With both internal and external growth, the stocks of working capital, such as raw materials and other inputs, will have to increase. This is so because these vary directly with output and more will have to be purchased to meet additional output requirements. The business will therefore have to access sufficient financial capital to meet these additional costs.

- iii. **Labour:** The nature of growth of a business will influence its impact on labour. If growth is internal, the existing labour force may be inadequate and the business will need to hire additional people with the same skills as existing workers. However, if the internal growth is a result of product diversification, there may be a need to hire

additional people with different skills. Business growth therefore affects both the quantity and quality of labour required.

When the growth is external, the labour force of the joined firms automatically increases. Sometimes there may be sufficient jobs available to warrant the retention of all workers and the business will continue its progress effectively. However, at times there may be a duplication of workers and it may be necessary to either ask some people to leave or retrain them to fill other available positions. The former option will generally trigger labour disputes and usually a large amount of money will have to be paid out as severance benefits for those who are asked to leave the organisation. In whatever way labour is affected, consideration must be given to the cost effectiveness for business profitability, as well as the “human factor” and how these changes will impact employees.

- iv. **Scale of production:** This refers to the physical size of business operations in terms of the quantity of goods and/or services it is able to produce and offer for sale. The advantages a business enjoys because of large scale production are called “economies of scale.” These advantages are measured in terms of the reduction in unit costs of production and the increase in efficiency that the business is able to achieve. This section will focus on the following three economies of scale:
- a) **Technical economies of scale:** A large business that is able to afford and efficiently use modern machines and technology will produce a much larger output in a shorter time span when compared to smaller firms that do not have these facilities. The advantages derived from this large scale production are lower unit or average costs of production and increases in both levels of output and productivity.
 - b) **Marketing economies of scale:** A large business buys the raw materials and other inputs needed for production in bulk. As a result, it gets special discounts from suppliers and this serves to reduce unit costs of production. This advantage of lower prices enables large firms to be more cost efficient than smaller firms, which are not able to qualify for bulk discounts because they purchase inputs in smaller quantities. A large business is also able to employ marketing specialists who can adopt strategies to increase sales turnover. This will justify the large scale of production as the business will be assured of sufficient demand for its large output. Another aspect of cost saving enjoyed by large businesses is in the marketing area of advertising. For example, an advertisement of the same size featured in the daily newspaper will incur the same total cost to both a large and small firm. However, since the output of the large business is higher, the unit costs are spread wider and will be lower than that borne by the business with the smaller output.
 - c) **Financial economies of scale:** It is usually cheaper for large businesses to raise financial capital than it is for small businesses. The actual cost savings arise from the fact that

because of their large capital and asset base, financial institutions are willing to offer them larger loans at lower interest rates than what they would offer to small businesses.

- v. **Use of technology:** Growth of businesses usually open up additional opportunities for the use of technology at all stages of the production process. Even though the initial cost of acquiring modern updated technology may be high, the eventual savings justify the expenditure. Let us identify a few examples of how technology can be incorporated in a larger size business to positively impact its productivity and profitability.

In the primary stage of production, a small agricultural business engaged that expands its operations will use more machines instead of relying on manual methods. Additionally, new techniques of practising agriculture can be applied and this will serve to increase expertise and crop quantity and quality.

At the secondary stage of production, large businesses have a greater scope for using technology, which results in mechanised and automated operations that positively impact productivity levels. Computers can also be incorporated for use in designing, manufacturing, product testing and many other areas.

The benefits of technology in the service industries of tertiary production are well known. In our modern day economy, almost all large businesses now make use of technology for online retailing, banking services, making payments, communication, and even security. Please do not think that the use of technology is limited to large businesses. Many small businesses use technology as well; the point that is being stressed here is that as a business grows it might be in a better financial position to purchase and utilise more technology.

- vi. **Potential for export:** As a business grows, it produces either a larger output or a wider range of products. Once the domestic market has become saturated, most businesses look to the global market for sales. To compete, successfully firms need to maintain high quality products that meet international standards. The use of the internet and e-commerce, as well as tremendous developments in transport and communication, have served to increase the accessibility of export markets for businesses that produce surplus output for export.



Activity

Recently, the small hairdressing salon in your neighbourhood has experienced a rapid growth in clients. The owner wants your opinion on how this can impact the labour and capital requirements of the business. Write your response to this business owner. Use the lines provided below.

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Check your response with the one provided in the Learners Guide.

Challenges Large Businesses May Encounter



Reflection

Can you think of any problems a business may experience as it grows in size and complexity? Do you think a business can continue to grow indefinitely?

Your reflection on the above questions may alert you to the fact that despite the advantages of growing as a business, sometimes challenges may be encountered.

Some challenges faced by large businesses

1. **Market saturation:** This can occur when the majority of people who desire a particular good or service have acquired it so there is little or no new demand. For example, let us assume that everyone who wanted a particular type of cell phone has already purchased one. Since this is a product that can be used over and over again for a relatively long period of time, people will not want another one in the near future. As a result, the business will experience a fall in demand and will not need to operate at its large full plant capacity. Additionally, in some businesses, stocks of products may pile up and these may have to be sold at lower prices to recover expenses. However, this problem can be avoided by:
 - Conducting timely market research to forecast sales trends so adjustments can be made to production targets
 - Making product improvements to rejuvenate sales

- Accessing new markets for the product

2. **Inability to readily respond to changes in market demand:** Usually equipment and machinery used in large businesses are highly specialised and suited for mass production of a particular good or service. If there is a fall in demand, a large firm has less flexibility and may not be able to easily switch production to another product. As a result, it can lose its competitive edge and incur losses due to falling sales. To deal with this problem, the business will have to try to make product improvements and adopt marketing strategies that will revitalize demand.
3. **Increase in wage bill for managerial and supervisory staff:** Recall from the last section that due to a bigger labour force large businesses usually need to create new middle management and supervisory positions. The hiring of people to fill these positions can sometimes increase the wage bill to such an extent that the unit cost of production rises. Since this is unavoidable, businesses will have to look for other ways of cutting expenses to make operations more cost effective.
4. **Communication problems:** When a business gets too large, problems in communication may occur. The lines of communication get longer as the organisational structure becomes taller and more complex. Recall information on this from the previous section. This can cause messages to take a longer time to reach intended people. In addition, there may be an increase in paperwork and bureaucracy, or “red tape”, as the latter is sometimes called. As a result, decision making may take longer and this can have a negative impact on the business and generally cause costs to increase.
To avoid the problems associated with this, the business needs to ensure that channels of communication are clear to everyone and that there is effective co-ordination among departments.
5. **“People problems”:** A major problem facing many organisations that get too large is the “people factor”. With an extremely large labour force, people may become alienated from management and not develop any sense of loyalty to the business. Some may feel like mere statistics and this can be a disincentive to work. Unhappy workers tend to take more time off and not work as efficiently as they can. If this is coupled with poor interpersonal relationships among workers, it can have a negative effect on productivity and profitability.



Discussion

To deal with people problems, management can adopt different strategies to motivate workers. Suggest some strategies to motivate employees in order to get the best out of them. Discuss these with your classmates/tutor.

Some suggestions you discussed may include the following:

- ✓ Providing opportunities for professional development
- ✓ Formation of smaller teams
- ✓ Encouragement of participative decision making among workers so they feel that their views are being considered.
- ✓ Providing occasions for social interaction among management, workers and sometimes their families
- ✓ Tangible or extrinsic rewards for work well done

The above strategies are usually quite successful in motivating employees and developing a sense of loyalty to an organisation. You will learn more about this in the unit on management.

Session Summary



Summary

In this session you learnt why and how a business grows, and examined the effects of growth on different aspects of the organisation. Let us now review the main points.

- Businesses may grow because of the following reasons:
 - ✓ The market demand for the good or service being produced increases
 - ✓ To diversify and expand its existing product range by adding new products.
 - ✓ The owners are willing to undertake additional risk and venture into new markets

- Businesses may achieve growth internally or externally.
 - ✓ Internal growth is a decision to expand within its existing structure. This may be through “ploughed back” profits, loans from financial institutions, inviting new and existing shareholders to purchase shares or changing the form of business organisation to one that will have more owners to contribute share capital.
 - ✓ External growth is achieved through integration, which is when a business joins with other businesses to form one larger organisation. The two major types of integration are takeovers and mergers.
 - ✓ Integration can be horizontal or vertical:
 - Horizontal integration occurs when firms at the same stage of production join.
 - Backward vertical integration occurs when one firm joins with another that is involved in an earlier stage of production.
 - Forward vertical integration occurs when a firm acquires ownership of one at a later stage of production.
- Growth of a business usually affects its organisational structure, capital and labour requirements, scale of production, use of technology and potential for export.
- Some businesses may experience problems as they grow. These include:
 - ✓ Inability to readily respond to changes in market demand because of large specialised technology
 - ✓ Increase in the wage bill because of the need to hire additional middle managers and supervisors
 - ✓ Problems in communication and increased paperwork and bureaucracy, which can be time consuming and costly
 - ✓ With a very large labour force, interpersonal problems may arise. This can negatively affect workers’ morale and hence the productivity and profitability of the business

- Timely market research, adoption of different strategies to motivate workers, and organisation of opportunities for professional development and social interaction among staff are a few suggestions to deal with some of the problems that businesses experience as they grow.

Assessment

You should spend thirty minutes on the two questions in this assessment. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.



Assessment

1. Complete the following sentences by inserting the missing word from the list below: (10 Marks)

market saturation, diseconomies, wider, plant capacity, marketing, merger, backward vertical, diversification, taller, financial, takeover, horizontal.

- a) Reductions in unit costs experienced when a business buys raw materials in bulk are called economies of scale.
- b) Larger businesses enjoy economies of scale because banks lend them bigger loans at lower interest rates when compared with what is offered to smaller businesses.

- c) When a business that has grown in size creates new middle management and supervisory posts, its organisational structure gets
- d) The establishment of new functional departments causes the organisational structure to get
- e) integration occurs when a business joins another business at an earlier stage of production.
- f) integration occurs if the businesses which join are at the same stage of production.
- g) To increase its scale of production, a business will have to increase its
- h) Adding new products to its existing product range is referred to as
- i) A business experiences when the majority of people who desired a product have already purchased it from the business.
- j) When businesses mutually agree to join, this is called a

2. Explain **two** effects that the growth of a business will have on each of the following:

- a) Its organisational structure (2 marks)

- b) Its potential for export (2 marks)

- c) Its capital requirements (2 marks)

- d) Its technology (2 marks)

e) Its labour requirements (2 marks)

Total: 20 marks

Session 4: Cottage Industries

Introduction

If you had the opportunity to be an employee in a well-paid 8 a.m. to 4 p.m. job that is several miles away from where you live, or the opportunity to open a small business in your own home of which the financial rewards may not be very high at first, which would you choose? Your answer will, of course, depend on your unique circumstances and preferences.

In this session you will learn about cottage industries, which are basically small home-based businesses, and be able to understand why they are so prevalent.

Upon completion of this unit you will be able to:



Outcomes

Describe the characteristics of cottage industries.

Discuss the benefits of cottage industries on the individual and the economy.

Identify incentives given to cottage industries.

Cottage Industries



Case Study / Example

Read the following scenario and answer the question which follows.

After she graduated from high school, Jane worked in a garment factory for five years but she never really enjoyed it. She had to get up very early, travel for thirty miles, and spend the day in front of a sewing machine in a hot crowded room. When she got home late in the evening, Jane was too tired to look after her family.

Jane decided to leave her job and open her own business at home. She printed fliers which she distributed to neighbours, stating that she would be sewing custom made clothing for females and household items like curtains and cushions. Jane soon had several customers and her business was off to a good start.

What benefits was Jane able to enjoy by opening her own business at home? Write your answer in the lines below.

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Check your answer with the one in the Learners Guide.

This bold move by Jane provides us with an example of a special type of small business called a cottage industry.

A cottage industry is where production of a good or service takes place in a person's home instead of on the premises of an established factory or manufacturing firm. Only very simple tools and equipment, which are usually found in the home, are used.

Let us look at some examples of productive activities in cottage industries:

- A stove, refrigerator and other simple appliances in the kitchen of one's home is used to make food products like cakes, pastries, preserves or jams.
- The use of another room in the home to make craft items, or to sew products like Jane did.
- The use a room at home to offer personal direct services, such as hairdressing or barbering.
- The use of a garage or adjoining room to produce furniture or repair cars.
- The use of land around the home for planting crops or rearing animals for sale.

There are numerous examples of people operating small businesses from their homes. Look around the community in which you live and try to identify some additional examples.



Reflection

Imagine you have your own small business at home like Jane. What are the benefits of working at home compared to working for someone else or buying/renting factory space to establish a business?

Let us examine how the benefits you thought about match the ones outlined below.

Benefits of cottage industries

Recall the importance of small business you studied in Session 2 of this unit. These functions performed by small business are all relevant to cottage industries and show the benefits that will be conferred on the economy.

The focus of this session is on the benefits of being a owner or operator in the cottage industry.

Major benefits of cottage industries

1. **Low start-up expenses:** A cottage industry usually has low or minimal start-up expenses. Production takes place in the home using simple equipment already possessed. As a result, costs of production are relatively lower than if a person has to rent or buy factory space and more sophisticated equipment. This gives the owner of the cottage industry a cost advantage and serves as an incentive to establish a home business.
2. **Assistance from family members:** In a cottage industry it is possible for family members to assist in their own time and at their own pace. This reduces labour costs and the flexibility in working time contributes to higher productivity.
3. **Important source of income:** By operating a cottage industry, many persons get the opportunity to gain financial independence and earn money without having to leave the home to go out to work. Additionally, the owner of a cottage industry can make an important contribution to production while still looking after the family and saving expenses that would have been incurred for childcare.
4. **Increased use of materials and skills:** People can use their skills to

convert easily available and relatively cheap materials into useful products, and then earn a profit from selling them. This is evident in the abundance of successful cottage industries in the area of crafts, where materials like shells, bottles and clay are used to make items that have a ready market, especially among tourists. Other examples include people using their culinary skills and fruits from home gardens to make preserves and candies.

5. **Development of a sustainable skills base:** Cottage industries help to increase the skills base of people and equip them with knowledge that leads to sustainable development of home based production. Families tend to pass on their unique skills and “secret recipes”. It has become a tradition for members to continue the business from generation to generation with a great deal of success and loyal support from customers who value the unique and personalised good or service. Think of family businesses in your community which have successfully survived for generations. In Trinidad, the family business of “Doubles” was first started by a family.

The benefits of cottage industries serve as incentives for them to continue operating. The predominance of cottage industries suggests that any challenges they may face are not really stumbling blocks. Many people continue to pursue their dreams of owning a home business.

Incentives to cottage industries

Recognising the importance of cottage industries to both individuals and the economy, many governments usually provide a supportive environment to encourage their development. The necessary framework is put in place to offer incentives in areas such as training, financial support and marketing to both existing and potential home business owners.

Main incentives given to cottage industries

1. **Training:** Many governments fund special training programs which target unskilled or unemployed people and women who are at home. The aim is to provide opportunities to equip people with essential skills for undertaking production and managing a small business at home. These programs are made conveniently available throughout the country so that people can easily access them. Courses are offered in a wide range of areas, including cake decorating, food preparation, tailoring and dressmaking, home furnishing, landscaping, carpentry, auto mechanics and business management. Equipped with any of these skills, it becomes quite easy for someone to begin a business at home and enjoy most of the benefits outlined in the previous section of this session.
2. **Financial assistance:** To further enhance the development of cottage industries, governments may also provide some financial support. Special agencies are established to provide “soft” loans or “micro

credit” to assist people who would not be able to receive financing from other lending institutions but who have a good business plan for a small business. These loans have relatively low rates of interest, with easy repayment terms designed to suit the needs of the borrower. Additionally, professional advice and support are provided by the agencies to ensure that the money is used for the purpose it is lent; this allows people benefit from the operations of the business that is established.

Some types of production in cottage industries also qualify for special subsidies from the government. Subsidies are monetary grants given to assist with production expenses. Unlike loans, these do not have to be repaid. The money is provided in an attempt to pay some of the costs incurred in production so that the output can be sold at a lower price to consumers. What types of production qualify for subsidies? The answer is agricultural production of essential goods like vegetables, fruits, meat and milk. For example, in Trinidad and Tobago many small farmers are given subsidies to purchase seedlings, fertilizers, tools and small equipment that are needed for production to take place in their home gardens. Why do you think the government primarily gives incentives for food production? You can discuss this in your class.

3. **Marketing assistance:** Producing an output and not being able to successfully market it can be disastrous for a business. Recognising the problems that small businesses may face in this area because of competition from larger, more established ones, governments also try to give assistance in the area of marketing. Support is provided through advice given on procedures to follow for successful marketing, available markets and how to gain access to them. Many opportunities are given for these small producers to showcase and sell their products at trade fairs organised by the relevant government agencies. Vendors’ booths are also made available at strategic locations, such as the airport and seaport, for owners of cottage industries to sell their locally made products to interested tourists.



Activity

Imagine that you have the opportunity to start a cottage industry. Describe the business activity you would choose to pursue. Highlight three types of assistance you would be able to get from your government and how this will contribute to the success of your business. Write this in your scrapbook, under a new heading entitled “My cottage industry”.

Session Summary



Summary

In this session you learnt about the characteristics and benefits of cottage industries.

- Cottage industries refer to home based production where simple tools and equipment are used to produce goods, such as preserves, candies, meals, bread, cakes, pastries, and craft items. Cottage industries may also offer services such as hairdressing and beauty culture, sewing, tutoring, and repairing vehicles and appliances, to name a few.
- Cottage industries enjoy the advantages of being easy to start up with minimum expenses and being able to get help from family members. Cottage industries also allow people use their skills to gain financial independence in a convenient way.
- Despite the challenge of competition from large businesses, cottage industries continue to develop and survive because of their important roles and incentives received from the government.
- Some of the incentives and assistance given to cottage industries by the government include loans, subsidies, advice, training and market opportunities.

Assessment



Assessment

You should spend ten minutes on this assessment. Circle the letter which corresponds to the most appropriate answer for the following multiple choice questions: (5 Marks)

1. Which of the following is not a feature of a cottage industry?
 - (a) Low start-up expenses
 - (b) Assistance from family members
 - (c) Mass production
 - (d) Use of simple tools and equipment
2. Which of the following is the least likely to be done in cottage industries?

- (a) Assembling cars
 - (b) Repairing cars
 - (c) Making craft items
 - (d) Preserving fruits
3. Governments often provide assistance to cottage industries in all of the following ways except
- (a) loans.
 - (b) taxes.
 - (c) subsidies.
 - (d) training.
4. Cottage industries engage in
- (a) factory based production.
 - (b) country based production.
 - (c) large scale production.
 - (d) home based production.
5. All of the following are incentives given to cottage industries, except
- (a) training.
 - (b) high interest loans.
 - (c) advice on business management.
 - (d) information on markets.

Total: 5 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Assignment



Assignment

This assignment consists of three questions.

Imagine that you are given the opportunity to establish a small business to produce canned and bottled fruit juices.

- (a) Outline three factors you will consider when choosing a location for your canning and bottling of fruit juices business. Explain why each of these factors is important. (9 marks)
- (b) In your operation as a small business, you may encounter several challenges. State two possible problems you may face and recommend possible solutions to prevent or solve them. (4 marks)
- (c) Assume that after several years of operating as a small business you decide to expand to meet the growing demand for fruit juices. You have the option of entering either a vertical merger or a horizontal merger. Present arguments in favour of the two types of mergers and explain which one you will choose. (12 marks)

Write your answers on your own paper. Clearly label the unit assignment and the responses to the questions. When you are finished, submit it to your tutor for evaluation. You may be asked to include the session assessments you have completed and self-marked in this unit.

Total: 25 marks

Unit 6: Management

Functions, Responsibilities and Organisational Structure

Introduction

Organisations, whether they are multinational companies or small one man businesses, are driven by people. People form the backbone of all organisations. Traditionally, organisations were seen as being divided into two groups of people. There were those who conceived and implemented the ideas, and those who were a part of the production process. The first group is referred to as the managers and the second as the employees. The managers form the management of the organisation and have the authority to give orders to the employees.

Today managers are more progressive and most are now trained to guide, support and motivate employees. Management realises that they are not the repository of “know-hows” but have to rely on technologically savvy employees to get the work done (Nickels, McHugh and McHugh, 2005). Business growth depends on progressive management, which involves planning, organising, directing and controlling.

This unit will introduce you to the management functions that must be performed so that the overall success and efficiency of a business can be achieved. In addition, you will learn about the responsibilities to stakeholders that management must fulfill. The separation of a business into functional areas and the way in which these areas may be structured will also be explored.

Upon completion of this unit you will be able to:



Outcomes

Explain the functions of management.

Discuss the responsibilities of management to different stakeholders.

Explain the functional areas of a business.

Describe the organisational structures used by businesses.

The sessions in this unit are:

Session 1: The Functions of Management

Session 2: The Responsibilities of Management

Session 3: The Functional Areas of a Business

Session 4: Organisational Structures of Businesses

Time frame: Twenty hours (20 hours)

Session 1: Functions of Management

Introduction

In Unit 3 you learnt about different forms of business organisations. Remember that all businesses have someone in control of the business affairs. In large international businesses, this may be a group of people whereas in small businesses it may be just one person. This group of person(s) forms the management of the business. The success of the business mainly relies on the person(s) in charge. In carrying out the management roles, many functions, such as making accurate and timely decisions, are performed. To assist management in making decisions, management information systems may be used.

In this session, therefore, you will focus on who and what is management. You will explore the functions of management and the benefits of using a management information system (MIS).



Outcomes

Define the term “manager”.

Explain the term “management”.

Describe the main functions of management.

Discuss the importance of management functions to a business.

Discuss the benefits and limitations of management information system.



Terminology

Planning:	Setting objectives and devising strategies to meet objectives.
Organising:	Setting up systems, policies and procedures to govern the running of the business.
Coordinating:	Combining the factors of production to ensure business operations run smoothly.
Controlling:	Measuring and checking performance and taking corrective action to meet targets set.
Directing:	Giving instructions to employees so that they can perform their tasks efficiently and effectively.
Motivating:	Encouraging employees to contribute their best effort to their jobs.
Delegating:	Giving employees the responsibility and authority to carry out tasks that the manager usually performs.
Objective:	The desired result that businesses wish to achieve in a given time frame.
Vision	A summary of what the business intends to do and become in the future.
Mission	A statement outlining why the business exists and the relationship it intends to have with its customers and other stakeholders.

Who is a Manager?



Reflection

From your general observations, who do you think are managers? Share your thoughts with others in the class.

Some of your answers may be that managers are business owners, people who direct the affairs of groups or people who are in charge of others.

You are correct since these are some of the tasks that managers perform.

Have you observed that sometimes owners are not necessarily the managers?

If your answer is “yes” then you are correct. Managers can be business owners or those employed to manage organisations owned by others.

A manager is the person(s) in the organisation who makes decisions and takes responsibility for planning, organising, directing, controlling, co-ordinating, delegating and motivating.

Now try the following activity. You should spend approximately ten minutes on it.



Activity

In Table 1 below list the activities you think will be performed by the managers of organisations or groups.

Type of organisation or group	Activities performed by the manager
Sole trader selling food products	
An insurance company	
Football club	

Figure 1: Activities performed by the manager of different organisations or groups

When you have completed this activity, share your responses with your classmates and tutor and check the Learners Guide. You can use responses from your classmates to expand your list.

Now that you have a comprehensive list of activities performed by managers, you can take a closer look at what management is.

What is Management?

The term “management” refers to the individual or group that determines how businesses should carry out their operations. The functions of management include planning, organising, directing, controlling, co-ordinating, delegating, and motivating. These functions are performed in all organisations so management skills and functions are said to be universal.

The diagram below illustrates the functions performed by management in all organisations.

Illustration of Management Functions

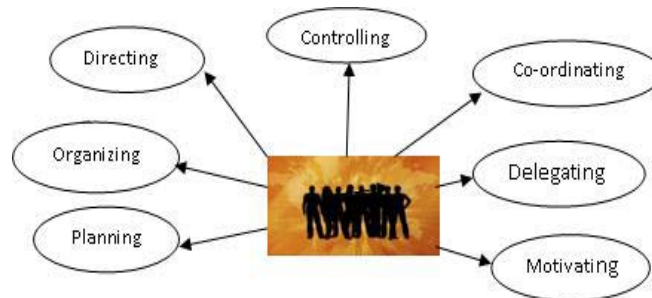


Figure 2

Now that you can identify the functions of management, you will now explore each one in detail.

The functions of management

Now take a look at these functions as they apply to businesses.

1. **Planning** is the process of making choices and decisions. It involves setting goals and objectives and then devising strategies to achieve them. An objective is the desired result that businesses wish to achieve within a given time frame and budget.

In some businesses, planning may take place informally. The manager, in other words, may not hold meetings or document any plans. He/she may have an idea, think about it and even “sleep on it”. Sometimes the idea may be shared with the other workers or partners in the business. Then the manager simply implements the idea.

For example, the owner of a store may have an idea to sell oranges for the carnival. He thinks it is a good idea so he shares the idea with his employees and then promptly sets about buying oranges wholesale so that he can resell them. This type of informal planning is very common in many small businesses. In reality, it is only when most small businesses need a loan that formal business plans are done.

All businesses, no matter the size, must prepare a business plan for financial institutions when applying for a loan or any type of funding. This is a detailed document outlining the overall goals and objectives of the business, the budget for achieving these goals and the timeframe in which these will be achieved. You will learn more about this in Units 10, 20 and 30.

Planning can be categorised according to the time frame in which the plans should be accomplished. The main types of planning generally used in businesses are strategic, tactical and operational. You will now examine each of these.

Main types of planning

a) **Strategic or long term planning:** This focuses on what the business intends to achieve in the next three to ten years. In strategic planning, management develops the vision and mission statements for the business. The vision statement is a summary of what the business intends to do and become in the future. The mission statement outlines why the business exists and the relationship it intends to have with its customers and other stakeholders. The vision and mission statements will be further explained in Unit 10.

Strategic planning also requires management to conduct a SWOT analysis of the business. SWOT is an acronym for the words Strengths, Weaknesses, Opportunities and Threats. You will recall that you learned about SWOT in Unit 2; you will meet the term again in Units 10 and 20.

Periodically, management revisits strategic plans and adjustments are made if necessary.

b) **Tactical planning:** This involves breaking down the strategic plan into short-term action plans that are achievable within a period of up to three years. In tactical planning, management sets objectives for the following areas of the business:

Production: Here decisions are made on what and how much to produce and what resources are required to facilitate production.

Marketing: Here decisions will be made on how goods and services will be sold, what markets to enter and how to compete effectively in the market place.

Finance: Management decides how to access funds to finance operations and what systems will be used for recording business transactions.

Human resources: The number and types of workers required to achieve the plans of the business will be determined by management.

c) **Operational planning:** These plans are for a period of up to one year and may include daily, weekly and monthly activities. They mainly focus on obtaining and allocating resources so that the business can function efficiently. Some of activities may be locating suppliers and supplies, advertising, recruiting employees, budgeting, and allocating funds for production and marketing operations. All these activities that are involved in the day to day running of the business will ultimately ensure that the vision and mission of the business are realised.

2. **Organising:** This follows the planning function. It involves bringing together the physical, financial and human resources and creating productive relationships among them to meet the goals of the business. In organising, management has to identify all relevant activities and group them according to specialised or functional areas or departments.
3. **Directing:** This is concerned with ensuring that employees know what to do. It involves giving clear, precise instructions to workers so that they can carry out their tasks effectively. Directing also entails supervisors overseeing the work of subordinates. Training is an important aspect of directing as this will equip employees with the necessary skills to perform efficiently.

There are various elements of training. Employees may be trained as they work. This is known as on-the-job training. When the employee is trained away from the work place, this is known as off-the-job training. Induction or orientation is the name given to the training an employee receives when he/she is new to the organisation. Here the employee is introduced to the organisation, the job and the other members.

Effective communication is a key component of directing for it entails instructing and guiding workers. In a small business the manager may only need to direct a few employees who may be family members. However, in larger businesses, managers may have more people to whom instructions have to be given. You will learn more about communication in Unit 7.

4. **Controlling:** In management, this does not mean “bossing” or dominating. It involves measuring and checking to see whether the objectives set during planning are being met. An important part of controlling involves monitoring operations. Controlling is important in a business to identify any existing or possible problems or deviations from plans. It will enable proactive measures to be taken to prevent problems from occurring or developing. However, if actual problems occur, then management can take corrective action.

A good example of controlling can be seen when a manager sets a target for sales. The actual sales figures would later be examined to see whether the sale targets were reached. If these targets were not met, then the manager would implement strategies to bring the sales figures up to the desired amount. One way of doing this might be to increase the frequency of advertisements.

5. **Co-ordinating:** This involves ensuring that all different departments of the business work together towards the achievement of common objectives. This is essential so that time, effort and resources are not wasted or duplicated in different departments. This may enable the business to be more cost effective and profitable. Important aspects of

co-ordinating include teambuilding and communication. You will learn more about this in Unit 7.

6. **Delegating:** This involves managers giving tasks and responsibilities to subordinates. The subordinates are employees lower in the hierarchical structure of the business who report directly to superiors. The manager should ensure that the subordinate understands what is expected and what standards need to be met. Along with responsibilities, the employees may also be given a specified amount of authority. Authority refers to the right to make decisions and give instructions to the people they are in charge of. The manager and subordinate should agree on when the tasks have been met and the responsibilities have been fulfilled. The manager is still ultimately responsible for the completion of the task that was assigned to the subordinate.

Delegating specific tasks can assist in increasing productivity and facilitating more effective time management. Assigning tasks to subordinates frees the superior to concentrate on other duties. Subordinates who are assigned tasks get the opportunities to learn new skills which can be beneficial in achieving business goals.

7. **Motivating:** This means encouraging employees to give their best effort towards meeting the goals and objectives of the business. This involves creating the right environment so that the employees work willingly and enthusiastically.

In order to motivate employees, management must consider the different needs of employees and the reasons why they choose to work. The work of Abraham Maslow, who was a psychologist in the 1940s, is one of the many theories of motivation.

Let us briefly examine this theory as it applies to a business. Maslow described a hierarchy of needs, which he said were essential to understanding why people behave the way they do. This is shown in the diagram below.

Maslow's Hierarchy of Needs

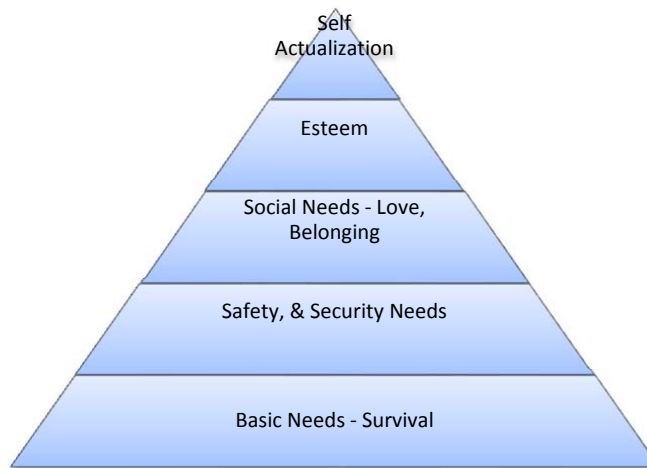


Figure 3

According to Maslow, the first level of needs that a person wishes to satisfy is his/her basic needs, as shown in the lowest level of the diagram. Basic needs are also called physiological needs and refer to things needed for survival such as food, clothing, water and shelter. In the business setting, when management pays employees their salaries this will enable them to satisfy these needs.

The next level of the hierarchy shows the safety and security needs, which refer to a person's desire for protection from harm and danger. When management provides insurance, job security and a safe working environment, this will meet employees' safety and security needs.

Social needs are on the third level of the hierarchy. These refer to the yearning for friendship, companionship and good working relationships. These can be met in the workplace when employees are happy with the inter-personal relationships existing in the business, for example, if there is a positive relationship between superiors and subordinates. Family days, outings and informal meetings also contribute to meeting employees' social needs.

Next in the hierarchy is the need for esteem and status. This includes praise, recognition, and affirmation given to employees. Management can satisfy this need by hosting recognition and award ceremonies. Praise for a job well done, promotions, job titles and status will also meet the ego needs of employees. Delegating is sometimes used as a means of motivating employees. Employees feel a sense of responsibility, accomplishment and empowerment when their esteem needs are met.

The highest level of the hierarchy is the need for self-fulfillment or self-actualisation. This is when employees need to feel that they are functioning at their full potential as individuals and achieving their personal ambitions. Some of the ways in which management can meet these needs are by empowering employees to

- a) contribute to decision making,
- b) determine their hours of work and
- c) select methods and systems they prefer to use.

When management successfully motivates employees, it will inspire them to give their best and contribute with renewed vigor and enthusiasm; this, in turn, improves the productivity and profitability of the business.



Activity

The activities listed below are performed by management. Use Table 2 to classify these activities into the respective management functions.

- Setting the standards for the product
- Assigning simple jobs to employees
- Giving schedules for the production process
- Meeting with specialist departments to ensure that they are working together to accomplish the goals of the business
- Giving a bonus to employees for completion of a job on time
- Deciding on the knowledge and skills needed for the jobs
- Preparing budgets and allocating funds to departments
- Bringing together the skills and raw materials needed to begin production
- Giving instructions on how the job should be done
- Giving praises to employees for jobs well done
- Deciding what will be achieved in the next 10 years
- Identifying all defective items

Table 2 Functions and activities of management

Functions of management	Activities of management
Planning	
Organising	
Directing	
Controlling	
Co-ordinating	
Motivating	

Figure 4

You can refer to the Learners Guide for feedback on this activity. From this activity, you should have been able to link actual activities of management with specific managerial functions.

An important aspect of organising is establishing systems for operating and making decisions in the business. One such system is known as an MIS. This stands for management information system. You will now examine what is a Management Information System.

Management information system

A management information system (MIS) is a system that uses computer technology to communicate with and give information to the management of businesses. Computer programmes and software applications are used to collect, store, process and communicate data from the different areas of a business.

You will recall that in Unit 1 the term “system” was explained to you when you learnt about an economic system. The concept of a management information system is similar to an economic system in that in a management information system, the input is the data collected. The data is stored and processed using various software applications that the management of businesses can use. This is the throughput. The output is the information that management obtains to assist them in making decisions for the business.

The computerised inventory system can be used to explain how a management information system can be used in the controlling of stock. The goods received are placed on the system. When goods are taken out of stock, that is also recorded and new balances are at the same time

found. Through this system, management knows the balances in stock of every item. This knowledge can assist them in the reordering of new stock and in the assessment of the value of their stock.

The major purpose of an MIS is to provide internal controls. These are policies, systems and procedures established to ensure that workers adhere to standards and ethical work habits. Internal controls also ensure that indicators of performance are set for jobs carried out.

An MIS provides accurate information in a timely manner to all managers within the business. For example, standardised sales, charts, tables, and financial, production and human resource reports are generated regularly for management's use.

The MIS uses electronic technology such as computers, fax machines, telephones and video to communicate information.

Types of management information systems

1. Transaction Processing Systems

Transaction processing systems are systems that carry out routine business deals. Each step in the transaction is determined and computerised programmes are designed to perform these steps until the transaction is complete. In other words, computer application software is designed to capture the information of transactions. The information is processed and a fixed outcome is received. Examples of some routine transactions are sales of goods and services, deposits and withdrawals of cash at banks, and payments of bills.



Reflection

Think about the checkout counter at supermarkets and stores. You will recall that the prices are scanned into point-of-sale terminals via bar codes on the goods. A bar code is a set of lines of varying width from which a scanner reads the price of the product. The lines are coded with digits from zero (0) to nine (9) and this data, when captured by the scanner, indicates the price of the good or service. The system also gives the total of the purchases made at that time and maintains an electronic record of the transaction. Figure 6.3 is picture of a bar code.

A bar code



Source: <http://upload.wikimedia.org/wikipedia/commons/c/c6/Barcode-EAN13-Bulgaria.jpg>

Figure 5

2. Office automation systems

Office automation systems are computerised tools and equipment used in offices to assist employees with performing routine tasks. The computerised tools and equipment digitally create, collect, store, manipulate, and relay office information needed for accomplishing basic tasks. The system is operated by the local area network (LAN). From the network, data is transmitted, and emails and voicemails are sent. Office automation has changed the way offices operate. It has changed the manner of dictation, the method of typing, filing and record management. These functions are now done electronically.

LAN is a network of computers located in a small physical space, such as a home, office or school. Each individual computer on the network can receive, process, store and transmit data. This means that data can be easily shared. LANs are capable of sending information at very fast rates but are limited in operation because it is restricted to the local area. To transmit messages to commuters within a country or across a region, the wide area network (WAN) must be used.

WAN is a computer network system that covers a wide geographical area. It may incorporate several LANs connected through a public telecommunication network. The largest WAN is the internet (Internet.com, 2010). An example of how WAN operates is outlined briefly below.

Your home or office computer may be connected to the telecommunication system in your country. For example, you might be connected to the Trinidad and Tobago Telecommunication System or the Jamaica Telecommunication System, which may be connected to a telecommunication system in another country, such as the Cable and Wireless Company in the United Kingdom or further connections across other continents.

You may recall that to facilitate these connections, wide area networks (WAN) use privately owned networks or rent these from existing networks. In that case, therefore, there is usually the sharing of networks.

3. Executive Support Systems (ESS) and Decision making Support Systems (DSS)

The executive support system (ESS) uses software packages to pull data from different aspects of the company's operations or departments so that the data can be summarised into useful reports. Data may be gathered from sales, human resources, production and marketing. The reports generated assist senior executives in the making of timely and accurate decisions.

On the other hand, decision making support systems respond to ad-hoc, one-time requests for information in specific situations. This system is more flexible and adaptable and requires more facilities, programs and applications than the standard MIS.

Benefits of MIS to organisations

1. It improves communication and decision making in organisations because correspondence to and from managers can be received quickly, thus allowing managers to be aware of what is happening in the business. In addition, the information is uniformly presented.
2. It provides a timely and accurate database that can be easily and routinely updated. You may recall that data entered into a computer system can be processed at any time and therefore the managers or executives can obtain reports at their convenience. Also, once the information is entered correctly, the information should be accurate as computation errors are less likely to occur than human errors.
3. It can bring about a reduction in labour costs since routine tasks can be computerised. Computerisation of regular office jobs often eliminates tasks conducted by people, hence reducing labour costs for most organisations.
4. It can increase productivity since related tasks can be performed more quickly. An MIS can operate for long hours at any time and is thus capable of gathering and reporting information much faster than humans. Information can be manipulated to produce varying reports much faster than the average worker and hence productivity may be increased.
5. It provides a system of standardised reports, policies and procedures which may enhance the decision making processes in the business. You may recall that an MIS produces pre-determined reports. These are usually laid out in a manner requested by the management of a company.
6. It saves space in offices because there are less hard copies (paper) of documents to be filed and stored in filing cabinets. Information can

be stored electronically on hard drives and compact disks and thus information retrieval may be at your fingertips.

7. It improves the monitoring of trends and movements in the relevant business markets so that the business can take advantage of opportunities that may be available. You may recall that data is stored electronically and therefore easy to retrieve. The management of organisations can easily retrieve information to compare trends over the years. Also, information about prevailing market conditions may be available, which may assist the management in positioning their organisation in the current market.

Limitations of MIS to organisations

1. Major changes in policies and procedures are costly, time consuming and will require retraining of staff. Any changes of the system would require redesigning the software by specialists and this may be additional expenses for organisations. Sometimes it may take a long time for these changes to be made and implemented.
2. Once installed, the system tends to be inflexible. It may not be easy to change the system to reflect the current environmental trends. You may recall that an MIS operates with preset or predetermined software which produces specific standardised information. In the first limitation, we discussed the cost involved in bringing about changes to the system and thus once implemented, management may find it difficult to change the software on a regular basis.
3. The system must be monitored because sometimes it may give inaccurate information to management. Checks and balances may be built into systems to ensure that data entered is accurate.

Session Summary



Summary

In this session you learnt:

- ✓ Management is the decision making process that performs the functions of management which include planning, organising, directing, controlling, co-ordinating, delegating, and motivating.
- ✓ Planning involves setting goals and objectives and then devising strategies to achieve them.
- ✓ Organising is bringing together the physical, financial and human

resources and creating productive relationships among them to meet the goals of the business.

- ✓ Directing is giving clear, precise instructions to employees so they know exactly what to do.
- ✓ Controlling involves measuring and checking to see whether the objectives set during planning are being met.
- ✓ Co-ordinating involves ensuring that the different departments work together to achieve the common goals and objectives of the business.
- ✓ Delegating occurs when superiors give tasks, responsibilities and authority to subordinates.
- ✓ Motivating means encouraging employees to give their best effort towards meeting the goals and objectives of the business.
- ✓ A management information system (MIS) is a system that uses computer technology to communicate with and give information to the management of businesses. Computer programmes and software applications are used to collect, store, process and communicate data from the different areas of a business.

Assessment



Assessment

Now let us see how well you have understood the functions of management.

This assessment is two parts: Section A (Parts **a & b**) and Section B.

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Section A:

- a) Identify the functions of management indicated in the following statements. (1 mark for each question below)
- b) State why you have selected the particular function to apply to the respective situation below. (1 marks for each question below)

1. Mr. Kase has been working at a factory for many years and he was recently given the “Employee Of The Year” award.
 - a)
 - b)
2. Jason’s boss is away for a few days and has asked Jason to complete the department’s progress report, which the manager usually prepares.
 - a)
 - b)
3. Every October, the managers of the business attend a retreat to set targets for the coming year and to review the performance of the previous year.
 - a)
 - b)
4. The manager of the production department has to order more stock and employ more workers to fill the increased orders for the Christmas period.
 - a)
 - b)
5. Carol is a new employee and is unsure of what she has to do. Mrs. James will instruct her about the requirements, duties and responsibilities of her new job.
 - a)
 - b)
6. The employees of DMS Enterprises enjoy their work because the salaries are competitive, managers provide a positive working environment and the workers are recognised for their contributions to the success of the business.
 - a)
 - b)
7. The Managing Director of the business is having a meeting with the department managers to agree on the financial allocations for the coming year.
 - a)
 - b)
8. Sales are falling. The Sales Manager has offered bonuses to his sales representatives to encourage them to bring sales revenues up to the targets set.
 - a)
 - b)

9. The Marketing Manager has decided to expand the sales staff and to introduce another level of management.
 - a)
 - b)
10. The company instituted a computerised database for accessing the records of employees.
 - a)
 - b)

(Section A Total: 20 Marks)

Section B: Read the following scenario and answer the question which follows.

Mr. Messoboy has been operating his neighbourhood parlour for the past fifteen years in Sobo district. The government recently expanded the area by building two new housing complexes. Mr. Messoboy has decided to convert his parlour into a supermarket. Previously, Mr. Messoboy bought items on impulse and did not consider specific areas for storage. Sometimes only he can find the items he wishes to sell. He would ask his children to assist when the store is busy but generally he makes all the decisions.

Explain how Mr. Messoboy can apply the functions of management if he wishes to make the new business successful.

(Section B Total: 10 Marks)

Total: 30 Marks

Session 2: Responsibilities of Management

Introduction

In Session 1 you learnt that managers are responsible for making decisions for the business. Employees implement these decisions as they work within the business. Management must also get things done with the help of other people who do not work in the business. You will recall from Unit 2 that these people are called stakeholders.

If a person owns and manages his own business, to whom is he responsible for making profit and conducting his business in a proper

manner? You may say that he is responsible to himself only. What about a manager who is employed to manage a business that belongs to someone else? You may say that, in that case, he is responsible to the owners. You would be partially correct for both questions, because there are responsibilities to other people and groups which must be fulfilled by owners and the employed manager if the business is to be successful.

In this session you will learn about responsibilities of management to the owner(s), the customers, the employees, the society, and the government.

Upon completion of this session you will be able to:



Outcomes

Identify the stakeholders to whom management has responsibilities.

Describe management's responsibilities to each stakeholder.

Discuss the importance of management's responsibilities to stakeholders.



Terminology

Fiduciary: Held in trust or on behalf of another person or party.

Proprietary: Having ownership of assets or property.

Ethical: Acting in an appropriate manner by considering what is right or wrong.

Legal: Acting in accordance with the law of the land.

Stakeholder: Anyone or any group that stands to gain directly or indirectly from being involved in the business or organisation.

Labour turnover: This rate at which employees leave the business.



Reflection

You are aware of the functions of management. Now you will examine these functions in relation to the responsibilities of management. Before identifying these responsibilities, think about the person or group of people that may have an interest in the business being successful.

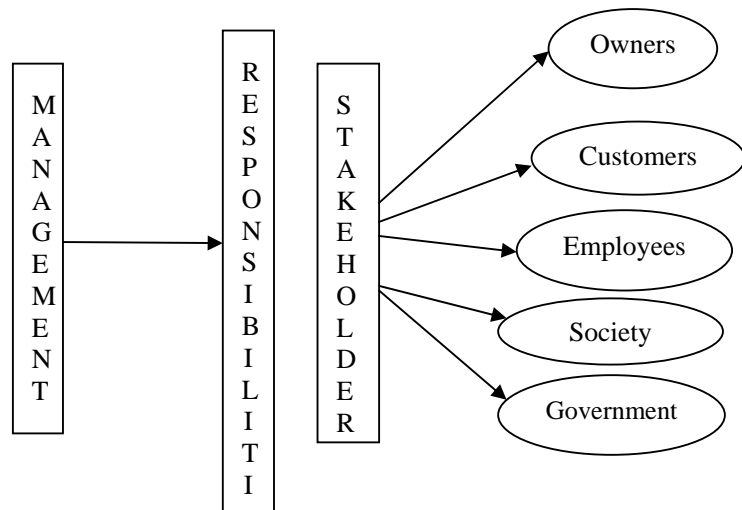
Have you considered the employees, the owners, the suppliers, the customers, and the community in which the business is located?

If so, you are correct.

Responsibilities of Management to Stakeholders

Examine the figure below which illustrates the stakeholders to whom the management of a business has responsibilities. You will recall that a stakeholder is any individual or group who has an interest in a business and can affect or be affected by its operations.

Stakeholders to whom the management of a business is responsible



As you go through this session, remember that management aims to fulfill the overall goal of an organisation, which is to make a profit or to bring satisfaction to its stakeholders.

Management responsibilities to owners

If a manager owns the business, his/her responsibility is known as proprietary. You are right if you have connected this word to the word proprietor. Both words have to do with ownership. Therefore, if the owner and manager are the same person, he/she has a proprietary responsibility to ensure that the business is profitable. He/she has more passion and drive to see the business succeed and therefore does not simply consider it a responsibility.

On the other hand, if managers are employed or contracted and acting on behalf of the owner(s) of a business, this is known as fiduciary responsibility. Fiduciary means “held in trust”. In this case, managers are entrusted with the resources of the business and have the responsibility to ensure that the business makes a profit so that the owners obtain dividends.

You will notice that in both instances, management has responsibility to make decisions that ensure profit is made in their respective businesses. So the first responsibility of management is to make a profit for the owners, who would have provided capital for the business. Remember that capital refers to all the monies and physical assets invested in the business. For this investment, the reward of profit is paid to the owner(s).

The task of ensuring that the assets of a business are properly maintained is also a responsibility of management. This is essential to ensure that the plant and equipment can function efficiently and promote profitability. This will enable owners to receive the best rate of return on their investments.

Management also has a responsibility to ensure that accurate and timely records and accounts are kept and are made available to all owners. This is important so that owners can review the operations of the business.

Again, because management is acting on behalf of the owners, there is a duty to act in an acceptable and appropriate manner towards all people and groups with which the business interacts.

Management responsibilities to customers

What would happen if a business did not have customers? There would be no one to purchase the goods or service produced and hence there would be no sales and consequently no profits. Customers are the reason that businesses exist. This is why management’s responsibilities to customers are so important for the survival of the business.

Management must provide customers with goods or services that are safe and of acceptable quality. These must be supplied at a fair price, on time and under the conditions that are agreed upon by both customers and the business.

Management must also ensure that the business environment is safe and not hazardous to the health and wellbeing of customers. Emphasis must therefore be placed on complying with all health and safety regulations.

A business benefits tremendously from fulfilling its responsibilities to customers. Customers purchase regularly and may give invaluable “word of mouth” advertising for the business when they are pleased with its service. It is correct to say that good customer relations lead to good public relations.



Discussion

Use an example of a supermarket to discuss how management can fulfill its responsibilities to its customers.

Management responsibilities to employees

Employees make things happen in a business. They produce and deliver the goods or services and may interact with the customers. You may agree that employees can “make or break” a business. Therefore management must take its responsibilities towards its employees very seriously.

Management must provide its employees with fair wages. The working conditions should be acceptable. There must be proper lighting and ventilation. There must be restrooms for both genders and the environment must be clean. Employees should also be provided with training when the need arises so that they can obtain promotions on the job. Management has an ethical responsibility to its employees to act in their best interest. You might remember from the last session that when these conditions are met, employees become motivated to work willingly and enthusiastically.

Management has the responsibility to engage in good and just industrial relations practices. These are formal relationships governed by labour laws and practices. You will examine these in more detail in Unit 7. If these responsibilities to workers are not carried out fairly, management would have the problem of high labour turnover and may be continuously short-staffed. In addition, the business may earn a negative reputation with regards to its treatment of workers and may find it difficult to attract suitable employees. Management may have to spend much more money on training and re-training workers to improve the level of customer service, and the profitability of the business may be adversely affected as a result.

Management responsibilities to society

The society in which businesses operate can be viewed from the perspective of the people who live there, as well as the physical environment. Management has the responsibility of ensuring that the operations of the business do not cause harm to people or the environment.

Those businesses which engage in the extraction of natural resources, such as mining, fishing and agriculture, have a responsibility to conserve resources. This is mainly to prevent depletion of resources and to ensure that there will be enough for future use. Also, the activities of the

businesses should not cause pollution or destroy the flora, fauna and natural habitat of the environment in which they operate.

Management has a responsibility to ensure that business operations do not have any adverse effects on people and their property. For example, activities should not be harmful to health, cause any inconveniences, or damage personal property. In the newspaper article below, the business (management) supported the journalist (the employee) in carrying out her responsibility to the Cancun community by exposing a child abuse ring.

The article below was taken from the Daily Express dated 17th September, 2010.

LONDON - A Mexican journalist who was arrested and threatened after exposing a pedophile ring is to receive a major writing prize.

Writers' charity PEN says Lydia Cacho is the recipient of its International Writer of Courage Prize, which goes to writers persecuted for their beliefs.

Cacho was arrested, charged with libel and received death threats after publishing a book about a child sex abuse ring involving business figures in Cancun in 2005.

The prize is presented alongside an award to a British writer, created in honour of Nobel Prize-winning playwright Harold Pinter. This year's winner is Hanif Kureishi, whose screenplays and novels include "My Beautiful Laundrette" and "The Buddha of Suburbia."

The awards will be presented in London on Oct. 20.

Businesses have a responsibility to assist in the development of the community in which they operate. They are expected to contribute through sponsorship of programs in the areas such as sports, recreation culture and education. They should also give donations to charities such as not-for-profit and non-government organisations.

Can you think of any businesses in your community that have perhaps sponsored a sports team, given scholarships to students or even sponsored a competition with prizes? All these activities would have been part of their campaign to enhance their image in the eyes of the community and to fulfill its responsibilities to society.

You might have heard of businesses deliberately understating their profits to defraud the government, dumping garbage in empty lots of land or purposely not hiring unemployed and qualified residents of the area. These may be viewed as unethical practices and should not be encouraged by management, which has a responsibility to operate in an ethical manner. You will learn more about this in Unit 9.

Management responsibilities to government

Management fulfills its responsibilities to the government by conducting business operations in a manner that obeys the laws of the land. Some of these laws deal with accounting procedures, which will be explained in Unit 29. Management has the responsibility to produce not only quality goods and services, but ensure that the goods and services produced abide by the laws set by the government. In the Sale of Goods Act, businesses must produce goods that will not cause injury to any person. This law will be further explained in Unit 14.

Management also has a responsibility to adhere to the Occupational Health and Safety law. This law seeks to protect workers against dangerous practices in the workplace. Some provisions under the law include adequate lighting and ventilation for all employees. The workplace must also be sanitary and workers must be provided with protective clothing. Disregard for these laws can result in the business being fined or, in some instances where the offences are deemed to be unsatisfactory, the business may be closed by the relevant government department. These laws are further explored in Unit 14.

Management should also adhere to all trade agreements that the country is required to honour. Some of these agreements focus on free trade among countries, such as the Caribbean Community (CARICOM), African Caribbean and Pacific countries treaty (ACP) and the European Union (EU). You will learn more about this in Unit 27. It is important for businesses to uphold these agreements to avoid putting the government and country in jeopardy.

Taxes are a major source of revenue for a country. Management has a responsibility to ensure that businesses pay all required taxes. Failure to pay taxes is both illegal and irresponsible as the government depends on tax revenue to finance public projects, as we will be discussing in Unit 22. There are also certain compulsory statutory deductions that businesses must take from their employees and remit to the government. Examples of these are National Insurance contributions and health surcharge payments in Trinidad and Tobago. Management has the responsibility to ensure that these deductions are made and remitted in a timely manner to the government. Failure to do this will result in employees not obtaining their due benefits from the government.

Session Summary



Summary

In this session you learned about the responsibilities of management to various stakeholders. The stakeholders are owners, customers, employees, society and government.

- ✓ The responsibilities of management to owners are:
 - To make a profit as a return for the capital provided.
 - To ensure that the plant and equipment can function efficiently and promote profitability.
 - To ensure that accurate and timely records and accounts are kept and made available to all owners.
 - To act in an acceptable and appropriate manner towards all people and groups with which the business interacts.
- ✓ The responsibilities of management to customers are:
 - To provide customers with goods or services that are safe and of acceptable quality.
 - To supply goods and services at fair prices, on time and under the conditions agreed upon.
 - To ensure that the business environment is safe.
- ✓ The responsibilities of management to employees are:
 - To pay fair wages.
 - To provide acceptable and safe working conditions.
 - To facilitate appropriate training and coaching.
 - To organise job-related counseling where necessary.
 - To act ethically and in their best interest.
 - To engage in good and just industrial relations practices.
- ✓ The responsibilities of management to society are:
 - To conserve natural resources and prevent their depletion so there will be enough for future use.
 - To ensure that business operations do not have any adverse effects on people and their property.
 - To assist in the development of the community through sponsorship of programs.
 - To operate in an ethical manner.

- ✓ The responsibilities of management to government are:
 - To conduct the operations of the business in a manner that obeys the laws of the land.
 - To adhere to domestic, regional and international trade agreements.
 - To pay all required taxes and make statutory contributions.

Assessment



Assessment

This assessment is 10 multiple choice questions. Please choose the most appropriate response and circle the corresponding letter. (10 marks)

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

- 1) The obligation of the owner towards himself to make his business profitable is known as
 - a) good business acumen.
 - b) being an entrepreneur.
 - c) a proprietary responsibility.
 - d) earning a living.
- 2) The word “fiduciary” describes the manager’s responsibility to
 - a) make profitable decisions for the resources held in trust.
 - b) make money by any means necessary.
 - c) make the owners of the business proud .
 - d) keep proper accounts and records for the business.
- 3) Paying taxes and operating the business lawfully are part of the manager’s responsibilities to:
 - a) the community
 - b) the local police
 - c) himself
 - d) the government
- 4) The employees, the government, the society and the customers are all examples of:
 - a) consumers who buy from the business.
 - b) stakeholders of a business.
 - c) groups of citizens.
 - d) people who are interested in the business.

- 5) When a business pollutes the environment, it is NOT fulfilling its responsibility to
- society.
 - present a good image.
 - the employees.
 - other businesses.
- 6) Which of the following is NOT a responsibility of the management to the government?
- to ensure that all safety laws are adhered to
 - to pay all taxes and national security benefits
 - to prepare audited accounts each year
 - to pay dividends to its shareholders
- 7) Responsibilities to employees include
- ensuring that pension benefits are paid on time.
 - engaging in charitable ventures so employees can benefit.
 - providing educational benefits for the employees' children.
 - providing employees with discounts for purchasing the company's products.
- 8) Which of the following is a responsibility of management to employees?
- To provide goods of high quality.
 - To motivate and inspire
 - To provide social programmes
 - To provide social amenities
- 9) Which of the following is a responsibility to owners?
- To keep workers motivated.
 - To ensure that consumers are satisfied.
 - To make high returns on capital.
 - To ensure that all taxes are paid.
- 10) A stakeholder is
- The conceiver of the idea for the business.
 - A person who stands to benefit from the business.
 - The person who provided a loan to start the business.
 - A person employed in the business.
- (I) and (II) only
 - (II) and (III) only
 - (II) and (IV) only
 - (III) and (IV) only

Total: 10 Marks



Activity

Review newspapers and collect information on examples of businesses honouring their responsibilities to their stakeholders, such as owners, customers, employees, the government and the society in which they operate.

Place the information you collect in your scrapbook and write a few lines to explain how the businesses are fulfilling their responsibilities. Remember to date the article and state the name of the newspaper for future referencing.

Session 3: The Roles and Functions of Management in Business

Introduction

Can you think of a small business close to where you live, work or go to school, maybe a shop, hair salon, or barbershop? What does the owner do? Who works with him/her and what do they do? Did you notice that the owner does practically everything? He/she purchases stock, hires and trains people for work, decides when and where to advertise, and sets the prices of the goods or services, among countless other tasks.

As a business grows and attracts more customers, many changes begin to take place. The business may employ more people, open more branches, manufacture more products and vary their services to customers. As a result, a need for specialised areas will eventually arise. These specialised services are then grouped into specialised functional areas called departments. Specialist managers are employed to run these departments so that the services can be performed more efficiently.

In businesses, there are generally four main functional areas which usually form functional departments. In this session, a large manufacturing business will be used to illustrate these functional areas. You will be able to identify the sub sections and the function carried out by each one.



Outcomes

Upon completion of this session you will be able to:

Describe the four functional departments of a large manufacturing business, as well as the sub sections of each.

Describe the functions of the sub sections of each functional department.



Terminology

Production:

The act of using inputs or raw materials to manufacture goods.

Finance:

All funds and monies obtained and used in a business.

Marketing:

The processes used to gain and retain consumers' interest in products and services. The processes include pricing, distributing, and promoting those products and services to produce a profit.

Human Resource:

The function within an organisation that focuses on recruitment, selection, training and career planning for employees in the organisation.

Functional Areas of a Manufacturing Business

Generally there are four major functional areas or departments in large businesses. These focus on the following specialised activities: Production or Operations, Marketing, Finance and Human Resource. It should be noted that the use of each department name may vary depending on the business. For example, in a manufacturing business, the department where goods are made is called the production department. In a business that provides a service, this same department would most likely be referred to as the operations department.

Major Functional Areas or Departments of a Business



Figure 6

Production or Operations Department

The role of the production department functional is to produce the good. It is responsible for turning the inputs into the finished product or service by engaging in a series of production processes.

A manager usually heads the production. In a typical large scale manufacturing business, this manager has overall responsibility for the five sub sections. The Times 100 has identified these sub sections as:

1. **The production and planning section:** This section plans the production process, and sets the targets and standards for the product. In planning the production of the goods management must first set the target, which is the estimate of the amount of goods to be made. This knowledge will assist in the planning. You will recall that in Unit 4 you learned about the factors of production. These included land, labour, capital and enterprise. In the planning of production, management therefore determines the land space, the type and skill of the labour, the machinery required and the support that would be used to co-ordinate the activities. These supports may also include management information systems.

The quality of goods is monitored during the production process. If there are defects, corrections are made to these goods. To improve and maintain quality this department works closely with the purchasing/logistic department and the design and technical

support department. The roles and functions of these departments will be explained below.

2. **The design and technical support section:** This section is responsible for designing the good to be made. The shape, size and drawing of the good are described on the product specification. The product specification also includes all the material that would be needed in making the product and the standard of quality of the good.

This department is also responsible for the design and any modifications that may be made to the product. It then develops and tests the sample of the product. During the development of the good, technical support is usually sought. Technical support includes conducting research to determine if it is worthwhile to produce the product. It also includes advice on what material to use and the most appropriate design to utilise. In addition, it gives advice on any computerised programme that may be available to assist in the development of the good.

3. **The purchasing/logistic section:** This section is responsible for the purchasing of quality material, necessary components and equipment that will enable the smooth running of the production process. This department works closely with the stores/warehouse section so as to maintain quality.
4. **The stores section:** The roles of this section include the stocking of material, tools, spares and equipment that may be necessary for the production process. A computerised system may be used to record inventory. The computerised system assists management in the making of timely and accurate decisions. All material must be properly stored so that the quality of the material is maintained.
5. **The works section:** This section has the responsibility to provide the essential maintenance to the production line and to carry out repairs to equipment and plants. This includes the daily maintenance of machinery and the annual cleaning and servicing of all machines used during production.

Marketing Department

The Marketing Manager heads this department. He/she is responsible for the operations of the various sub sections in this department. These sub sections are market research, sales, advertising and promotion, and distribution.

1. **Market research section:** This section conducts research on whether the product would be a success or a failure. To do this, potential consumers are asked questions related to their likes and dislikes and the price they are willing to pay for the product.

2. **The sales section:** The main role of this section is to co-ordinate the activities of the sales force. The sales force is made up of salesmen and delivery persons. These persons collect and fill orders from consumers. It may also deal with or forward complaints to the relevant section so that they can be addressed.
3. **The advertising and promotion section:** This section has responsibility for ensuring that people are aware of and persuaded to buy the goods and/or services that are produced by the business. This is done mainly through advertisements, sales promotions strategies and public relations. These topics will be dealt with in Unit 14.
4. **The distribution section:** This section gets the products to the consumer on time. It has responsibility for delivery of goods and services and sometimes may establish distribution outlets that are convenient to consumers. Again, this topic will be discussed in greater detail in Unit 14.

Finance Department

The Finance Manager or Financial Controller runs the finance department.

This department has responsibility for collecting, managing, investing and allocating all funds or capital needed to establish and operate a business. The finance department can be divided into the following three sub sections:

1. **Accounts payables & receivables section:** This section focuses on book keeping procedures, which includes the recording of daily sales, purchases and capital expenditure. Most companies now computerise these processes. This is further discussed in Unit 29.
2. **Payroll section:** This section is responsible for the preparation of salaries and wages. The department also has to remit, on a timely basis, all taxes and statutory deductions. Statutory deductions are compulsory payments that the government requires employers to deduct from wages and salaries of workers. These deductions are not taxes but are payments usually made for other services, such insurance benefits that are made to workers who contribute to the National Insurance Scheme. National Insurance benefits include receiving a pension when one retires at age 60 and maternity benefits for when female employees go on maternity leave.
3. **Internal auditing section:** This section is usually headed by an Auditor whose job is to give advice on acceptable accounting procedures. Auditors provide management with reports which may confirm or condemn the operations of the accounting

procedures. They also validate the end of year financial reports, such as balance sheets.

The annual preparation of accounting statements and financial reports, such as the preparation of balance sheet and profit and loss accounts, is done by this department.

Human Resource Department

The human resource department was formerly called the personnel department. It is headed by the Human Resource Manager. The major function of the human resource department lies in staffing, training, and the management of people.

The sub sections of the human resource department include:

1. **Recruitment, selection and training:** This section is responsible for the advertising of all jobs. This may be done within the business or externally via newspapers and the internet. The department also conducts interviews where the selection of new employees is made. The department is responsible for the organisation of induction programmes.

Induction programmes ensure that new employees get to know the employees working in other departments and become familiar with the rules and policies of the business. The policies and procedures may be stated in published manuals. Included in these manuals may be information on collective bargaining agreements.

Staff training is important if the business organisation wants to maintain a high level of work standards among its employees. The human resource department may provide training to employees who lack the required skills necessary for their present job or another position they are likely to fill in the future.

2. **Industrial relations section:** This section handles all matters related to employees' wages, salaries and conditions of work. The managers and industrial relations officers settle employee grievances with the representatives of the employees, that is, the trade union.
3. **Man power planning and development section:** This section anticipates the future work force of the organisation. The managers then compare the skills of the present workforce with what is needed in the future. If it is found that the present employees do not have the skills needed to perform future jobs, then either training is planned for those employees or the business searches the external job market for new employees. This section also maintains information on employees' qualifications and

skills. This information may be computerised as it is important to have this information in a timely manner when dealing with a query about staff.

Although each functional department in a business is separate and responsible for its own activities, there must be co-ordination of activities among all in order to achieve common goals and objectives.

Session Summary



Summary

In this session you learned about the four major functional departments of a large manufacturing business. These are: Production or Operations, Marketing, Finance and Human Resource. Each department has sub sections with responsibilities to perform specialised roles.

- ✓ The production or operations department has the following sub sections:
 - The production and planning section
 - The design and technical support section
 - The purchasing/logistic section
 - The stores section
 - The works section
- ✓ The marketing department has the following sub sections:
 - Market research section
 - The sales section
 - The advertising and promotion section
 - The distribution section
- ✓ The finance department has the following sub sections:
 - Accounts payables & receivables section
 - Payroll section
 - Internal auditing section

- ✓ The human resource department has the following sub sections:
 - Recruitment, selection and training
 - Industrial relations section
 - Man power planning and development section

Assessment



Assessment

Below is a list of activities and positions in a business. Please group them into their respective departments using the table below. Keep the grouping for another activity in Session 4.

sales manager, personnel manager, chief buyer, wages clerk, advertising, payroll, transport, sales representative, recruitment supervisor, product design, banking, cash, cheques, delivery, raw material stores, purchasing clerk, industrial relations specialist and quality control supervisor

Functional Department	Activities and Positions
Production or operations	
Marketing	
Finance	
Human resources	

Functional Department	Activities and Positions

Figure 7

Total: 15 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Session 4: Types and Features of Business Organisational Structures

Introduction:

Organisations, whether global, regional or local, can be effective if they are properly planned and organised. In the planning and organisation stages, structures need to be developed to meet the goals and objectives of these organisations.

In the last session, you learned about the four major functional areas of businesses, which are marketing, production, human resource and finance. How do people working in each department relate to the others? How do employees know to whom they should report? These questions are answered by understanding the structure of the organisation and the relationships that emerge from that structure. These relationships may be formal or informal.

Upon completion of this session you will be able to:



Outcomes

Distinguish between formal and informal organisations.

Explain the different types of organisational structures.

Illustrate the different types of organisational structures.

Discuss the advantages and disadvantages of each type of organisational structure.



Terminology

Organisational Structure:	An organisational structure shows the way in which the departments of a business are set up and how the employees report to and relate to each other.
Formal Organisation:	The structure that the management of the company establishes.
Informal Organisation:	The informal organisation refers to unplanned groups and associations that emerge as people work together and share common interests and skills.
Hierarchy:	A group of people organised vertically into successive ranks, with each level subordinate to the one above.
Authority:	The power or right to give orders or make decisions.
Span of Control:	The number of people who report to one manager in a hierarchy.
Chain of Command:	The flow of authority, responsibility and accountability from the highest level of the organisation to the lowest.
Subordinate:	An employee ranked below another employee in terms of office hierarchy.
Lateral	A movement along the same level on the organisational structure.
Vertical	An up or down movement along the organisational structure.

What is an Organisational Structure?

Organisational structure refers to the organisation, categorisation and delegation of tasks to achieve specific goals. It determines how business decisions are made and implemented at all levels of the business (eHow, 1999-2010). To facilitate control, an organisational structure ensures that reporting lines are clear and employees know to whom to report. Organisational structures give focus and direction to businesses.

Businesses may choose to be organised centrally or decentrally. When businesses are organised centrally, all major decisions, power and control are retained by a few managers. Standardised procedures are usually implemented throughout the business. In centrally organised structures, decisions made are generally in the interest of the entire business whereas in decentrally organised structures, decisions may only be to the benefit of one department.

When businesses are decentralised, decision making, power and control are shared with lower level managers. Decentralisation frees managers from making trivial decisions and thus they can concentrate on providing direction for the business. In addition, through decentralisation lower level managers may feel empowered and thus motivated to increase output. Furthermore, when decision making is shared with lower level employees, they may develop a sense of appreciation as to why decisions are taken.

Businesses may also choose to be organised hierarchically, divisionally or departmentally, geographically, or horizontally. Later in this session you will focus on the functional organisational structure but now you will concentrate on another feature of organisational structures, which is formal and informal structure.



Activity

Name the departments in your school or organisation. How were these departments formed?

You may say that these departments were set up by the organisation. If you did, then you are correct and are referring to a formal organisation structure.

The formal organisation structure

The formal organisation structure is one that the management of the business plans and sets up. It shows the official lines of authority, communication and responsibility within the organisation. It indicates to employees to whom they should report and for what they are responsible. It helps to prevent duplication of tasks and unnecessary conflict, as an employee will not have to report to more than one manager or supervisor in this type of structure.

When a person becomes employed, he/she becomes part of the formal organisation of the business. He/she is employed to meet the objectives of the business. The responsibilities of the job are communicated either by word-of-mouth or in a formal document called the job description. The job description outlines the requirements of the job and the position or person to whom the employee must report. The person in charge is called the superior and the employee is known as the subordinate.

The formal organisation is set up by the management of businesses to accomplish the business goals and objectives. The businesses may operate through specialist departments, such as the production or operations, marketing, finance and human resource departments, in order to meet these goals and objectives.

Organisations are made up of people who engage in their own social networks. These social networks form the informal organisation structure.

The informal organisation structure

The informal organisation structure refers to those unplanned groups and associations that emerge as people work together and share common interests and skills. For example, the group of co-workers that meets daily for lunch or the group that meets regularly to play football on weekends form the informal organisation structure.

The objectives of the informal organisation structure are not necessarily those of the formal organisation. When informal groups meet, they fulfill the employees' needs for friendship and a sense of belonging. Sometimes, because of the high feeling of morale and excitement that comes from meeting together, this may cause the group members to be more dedicated and enthusiastic about their jobs.

On the other hand, if members of the informal group individually or collectively have negative feelings toward their jobs, management or the business, they may influence each other negatively and thus the business may be adversely affected. In such cases, members of the group may work slower and less carefully, and in some instances, may sabotage the operations of the business.

In some businesses, informal groups are encouraged, recognised and sponsored by the business, as in the case of a sports club or team that is named after the business and is made up of employees.



Activity

1. Identify the personnel within your organisation or school that fall under the headings listed below.

Formal Groups	Informal Groups

Formal Groups	Informal Groups

Figure 8

- In the lines provided, state what benefits the school or the organisation can gain from formal and informal groups.

.....

.....

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.....

.....

The organisational chart



Activity

Examine the list you made of the departments or divisions in your school or organisation.

Arrange the list in terms of the power held by certain people. Start with the person holding the most power.

Draw lines to show the flow of communication.

What do you notice about these lines? Do they run laterally, vertically, horizontally or both vertically and horizontally?

Using this information, sketch a chart of your school or organisation.

Remember to place the positions with the most power at the top, moving down to the positions with the least power.

What you have drawn is an organisational chart.

An organisational chart is a diagram or visual representation of the relationships between the departments and the jobholders in a business. It may have a pyramid shape with clear lines of authority. Many companies are organised in this form.

Figure 6.5: Pyramid showing lines of Authority

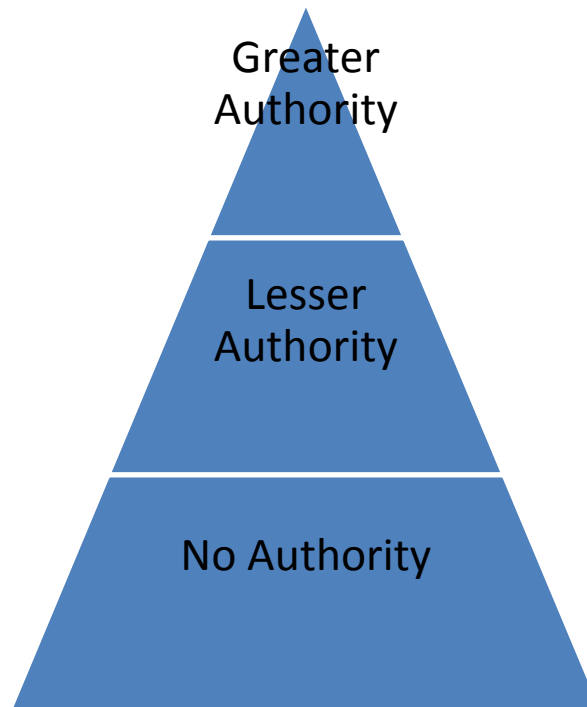


Figure 9

From the pyramid above we can learn that:

1. The position at the highest level of the chart has the most authority and those positions lower down have less authority. Authority is the right and power to give instructions and to expect compliance. The highest position carries with it the greatest right and power to command, direct and exact compliance.
2. The person(s) in each section of the pyramid is responsible for the operations of the section immediately below. In most businesses, the managing director is at the top of the chart. He/she has the highest authority and has the right to direct the actions of production, marketing, finance and human resource managers.
3. It is wide at the base and narrow at the top. This indicates that more people are employed at the lower level of the organisation and fewer people are at the top. In most businesses, senior management usually comprises the least number of people. There are more employees who make up middle management. Employees or operatives at the bottom of the pyramid make up the largest number. These are the people who

actually manufacture products or deliver services to customers. Supervisors are a small group between middle management and the employees. What the pyramid shows is that in a business there are more employees at the lower levels of the organisation than at the higher levels.

Let us examine the rules for drawing an organisational chart.

Rules for drawing an organisational chart

1. Positions or jobs with the same level of authority should be on the same level or line on the chart.
2. The chart should be labeled, dated and reviewed regularly. This is usually done at least once per year.
3. Where a business is large or too complex, it is difficult to show all positions on one chart. A simple chart should be drawn and separate detailed charts used to show each department or unit.

Here is an example of an organisational chart of a small business.

An Organisational Chart of a Small Business



Figure 10

What the organisational chart shows

The organisational chart above shows the lines of authority. This was discussed earlier. It also shows the responsibility of the department, supervisor and employees, the chain of command, span of control, levels of authority and areas of delegation.

You will now examine each in detail.

Authority: This responsibility was dealt with earlier in the session. Please make sure to review this topic of authority.

Responsibility: Responsibility refers to the level of duty or obligation that the manager or employee has. All members of any organisation have some measure of responsibility for the performance of their jobs. However, the higher in the hierarchy of the organisation a person is, the greater the responsibility he/she will have. Because of this principle, a greater measure of responsibility and accountability lies with the managers of organisations. Managers are therefore responsible for directing, controlling and co-coordinating the work of others. As with authority, the positions higher in the organisation have greater responsibility. This means that there are higher expectations for results with these positions and the jobholders are more accountable for decisions made.

In the above diagram, the managing director has the greatest responsibility in the business. In the same way, the marketing manager has more responsibility than the people below him/her, which in this case are the advertising and sales managers.

Chain of command: The chain of command is the flow of authority, responsibility and accountability from the highest level of the organisation to the lowest. The chain of command starts with the position of highest authority and flows downward through the organisation. For example, in our chart the chain of command starts at the managing director, and goes through any of the departmental managers (marketing, production, finance, human resource). The chain of command then continues to the next level (the advertising or sales manager), and then continues to the next level (the sales representative).

Span of control: The span of control is the number of workers or subordinates who report directly to a manager or superior. The span of control is also called the span of management. The diagrams below show both a narrow and wide span of control.



Figure 11: Narrow span of control

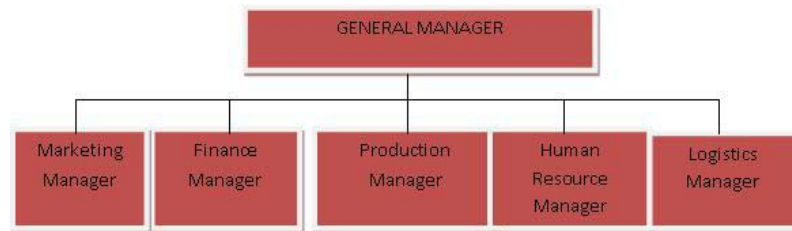


Figure 12: Wide span of control



Reflection

Why do we say the span of control is narrow?

If your answer is that there are only two managers under the control of the General Manager, you are absolutely correct. This means that he/she only has two people to directly supervise.

In the diagram above, how many people does the General Manager have to supervise directly?

Did you say five? If you did, then you are absolutely correct. This is therefore a wide span of control.

Now consider why spans of control vary in sizes. You may check your thoughts against the reasons given below:

There are a number of reasons why some spans of control are larger and others are smaller. Some of these reasons are:

- **The type of work:** Some jobs require more supervision than others. Managers of jobs that require more supervision may have a smaller span of control, that is, fewer people to supervise than the manager of jobs that require less supervision. If workers do not need close supervision, then the span of control may be wide and the organisation or department is considered to be flat. In a flat organisational structure, the middle management level positions are eliminated, meaning that top management is in direct contact with employees and customers. It may therefore be able to respond quickly to changing conditions and consumers' preferences. These structures are generally broad.
- **The skill and experience of the manager:** Managers who are more skilled and have more experience tend to have larger spans of control than new managers.
- **The type and size of the organisation:** Highly automated manufacturing businesses usually have large spans of control, especially in their production departments. Larger businesses, because of their size, usually have larger spans of control. Large manufacturing businesses usually have tall and narrow organisational structures.

- **Levels of hierarchy:** The number of levels describe whether the business is tall or wide. The word hierarchy usually describes the levels of management. Workers or operatives are lower down in the hierarchy.
- **Delegation:** A superior or manager can assign a task to his subordinate by transferring authority and responsibility to the subordinate. For example, in our diagram the General Manager can delegate some of his tasks, along with the required authority, to the managers or subordinates under him or her. The subordinate is accountable to the superior for completing the task, however, the superior is always ultimately responsible for the performance or completion of the task that he has assigned to the subordinate.

Organisational structures can also be describe as line, staff, and functional. Other types of structures, such as matrix and committee, are variations of these. In this session you will explore the line, staff and functional structure.

Line organisational structure

How familiar are you with the structure of a police station or any type of military organisation? This is the best example of the line organisational structure. There is direct flow of authority and command from top to bottom in a continuous line. Hence the name, line structure. It is also best suited to small organisations, such as small accounting firms or law offices. For example, at the top of a small law firm there may be a senior lawyer, followed by criminal and civil lawyers and law clerks. You should examine the diagram below.



Figure 13

The line organisational structure is very suitable for small businesses because there is no doubt over who is in charge of whom. Because there are clear lines of duties and responsibilities, decision making is easy and usually is of an informal nature. This type of structure is also decentralised because there are not many employees, hence line structure organisations are usually decentralised, decisions are reached quickly, control is easy and discipline can be administered promptly.

Staff structure

In the staff structure, there are a number of service departments that provide specialised services to the main operating departments. Officers in staff positions act in an advisory and supportive role to the line managers or personnel. The staff positions are generally shown by a broken line.

Some of these specialised departments may be security, legal, technical and information technology. In most cases, there are usually a combination of line and staff or functional and staff, as shown in the next diagram.

An example of a Line and Staff Organisation Chart

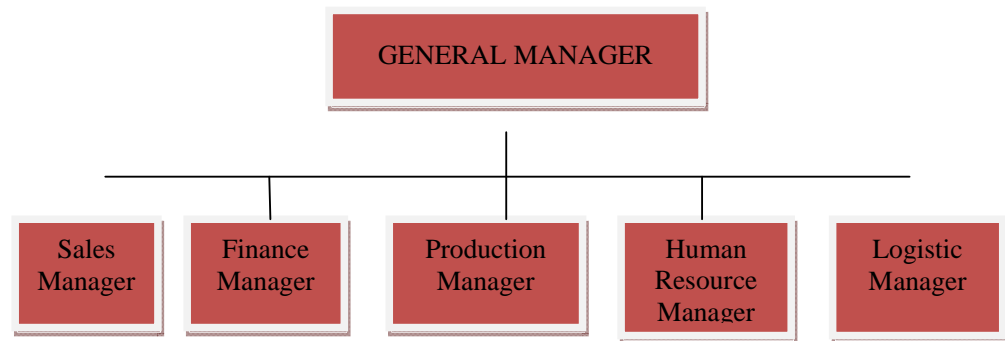


Figure 14

Functional organisational structure

The functional organisational structure is a structure in which the staff that engage in similar tasks are grouped into one department. Within the department, as you will recall, further subdivision is possible so that the functions can be carried out in an efficient and effective manner. This type of structure shows the working relationships among the functional departments of a business, sub sections and the specialists.

In the production or manufacture of a product, the common functional areas are production, marketing, finance and human resources. The role and responsibilities of these areas were dealt with in Section 3 of this unit.

Examine Figure 16 below, which illustrates three levels of the typical manufacturing organisational structure. In this organisational chart, you will note that the tasks are grouped into departments and that there are lines of command and communication.

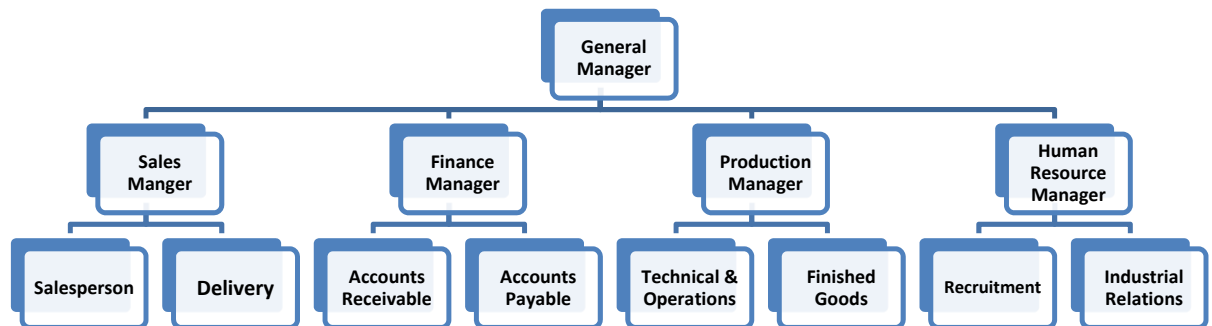


Figure 15

Session Summary



Summary

In this session you learnt:

- ✓ Organisational structure: This is the organisation, categorisation and delegation of tasks within a business to achieve specific goals.
- ✓ Businesses can be centralised or decentralised.
- ✓ Businesses have formal and informal networks.
- ✓ Organisational chart: This is a diagram or visual representation of the relationships between departments and jobholders in a business. It shows the lines of authority and responsibility.
- ✓ Authority: This is the right and power to give instructions and to expect compliance. The position at the highest level of the chart has the highest authority and those positions lower down have less authority.
- ✓ Responsibility: Responsibility refers to the level of duty or obligation which the manager or employee has.
- ✓ Chain of command: This refers to the flow of authority, responsibility and accountability from the highest level of the organisation to the lowest.
- ✓ Span of control: This refers to the number of workers or subordinates

that report directly to a manager or superior. The span of control of supervisors will depend on the type of work, the skill and experience of the manager, and the type and size of the organisation.

- ✓ Delegation of responsibilities with organisation varies depending on the structure.
- ✓ Organisations having line, staff or functional relationships.

Assessment



This assessment contains Section A and B. In each section, you will draw an organisational chart. For each one, use the positions listed. Remember the rules for drawing organisational charts. Use your own paper and label each question and answer carefully.

Section A: A School (10 Marks)

Here are the positions to include:

Heads of Departments (Mathematics, Science, Visual and Performing Arts, Languages, Modern Studies), Vice Principal, Principal, Math Teachers, Science Teachers, Foreign Language Teachers, English Language Teachers, Visual and Performing Arts Teachers, Modern Studies Teachers.

Now go a step further and put in these staff positions:

Secretary, Clerk, IT Technician, Librarian.

Section B: Scenario (10 Marks) Use the scenario below to draw your chart.

Mr. Samuel is the managing director of a medium-sized manufacturing business. There are four departments in this business: marketing, human resource, finance and production. A manager is in charge of each department. Each manager has an assistant. The management team has decided that the business should enter new markets by exporting. Mr. Samuel has hired a management consultant to advise and guide the

management on this new venture. The consultant has advised that the business should engage in research, development and quality control in order to become more competitive in the foreign markets. The consultant has also advised that an export manager be hired to deal with the new customers.

Draw an organisational chart for this scenario. When you are finished, show where export management would fit in the organisation. (10 marks)

Finally, answer the following questions on the scenario in Section B:

- (a) What was the span of control of the Managing Director before the changes proposed by the consultant? (5 marks)
- (b) Describe the chain of command from the managing director to the production department. (5 marks)

Total: 30 marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Unit Summary



Summary

Session 1 focused on the function of management, which includes planning, organising, directing, controlling, co-ordinating and motivating employees. The success of the business depends on how well management carries out these functions. Businesses may use management information systems (MIS) to assist in the organising and coordinating of the activities of businesses. MIS is an information and communication system designed to give management timely and accurate information. Maslow's theory of needs is one motivational theory that may be used by management to motivate employees.

In Session 2 you learnt that the management of a business is required to conduct business affairs in a manner that will provide dividends to owners. To customers, the business is responsible for providing safe goods and services at reasonable prices. These should be provided in a safe environment. To employees, the management is expected to pay reasonable wages and salaries. To the government, businesses must adhere to all laws and regulations.

In Session 3, you learnt that businesses, as they grow, may introduce specialists or functional departments headed by

professionals. These professionals are required to provide the technical expertise needed to improve product quality and business efficiency. Some examples of functional departments include production or operations, finance, marketing and human resource.

In Session 4 you learnt that in organisations there are formal and informal organisational structures. The formal organisational structure is established by management through the organisational chart, while the informal organisational structure is formed through the association of people with similar interests.

Organisational charts are common features of medium and large businesses in which specialisation occur. The chart gives an indication of the roles, responsibilities and authority of each department because it shows the chain of command and levels of hierarchy.

There are basically three main types of organisational structure: line, staff and functional. The line structure shows a direct line of command. Staff has an advisory and supportive role while the functional is the grouping of specialists into various departments.

Assignment



Assignment

This assessment consists of two parts. Section A is a scenario with 9 questions to answer; Section B is 15 multiple choice questions.

Section A: Read the scenario below and then answer the questions.

Mr. Sonnyboy began as the owner of a small video club in a rural district. This business was successful so Mr. Sonnyboy applied and was granted a rural radio licence to operate a rural radio station. After five years in the video club and radio station business, the government launched an incentive aimed at preserving local culture. This incentive required the filming of locally made productions, which included cultural competitions, such as the Annual Prime Minister Best Village Competition, Carnival productions and Religious ceremonies. To take advantage of this opportunity, Mr. Sonnyboy registered his business as Sonnyboy Media Company Ltd. The productions are to be sold locally and internationally. The expansion of the business caused Mr Sonnyboy to form new mission and vision statements, to conduct regular planning sessions and also to install a management information system.

1. What is a Mission Statement? (2 marks)
2. What is a Vision Statement? (2 marks)
3. What is a Management Information System? (2 marks)
4. State three benefits and one limitation that the business may experience because of the installation of the management information system. (4 marks)
5. Explain the functions that Mr. Sonnyboy would have to perform as the owner and manager of the small, rural video and radio station. (3 marks)
6. Identify the functional areas that would occur because of the conversion from a small video club and rural radio station to Sonnyboy Media Company Ltd. (3 marks)
7. Explain three functions of each functional area identified in question 6 above. (3 marks)

8. Describe three levels of planning in which the business should engage if it is to be successful. (3 marks)

9. Draw an basic organisational chart of Sonnyboy Media Company Ltd. (3 marks)

(Section A Total: 25 Marks)

Section B: Answer the following multiple choice questions by choosing the correct response.

1. The term “MIS” refers to
 - a) Management information software.
 - b) Management information system.
 - c) Managers induction software.
 - d) Managers incentives system.

2. Which of the following is NOT the responsibility of management to stakeholders?
 - a) To provide adequate dividends
 - b) To provide training
 - c) To keep accurate financial records
 - d) To interact with all groups in a professional manner

3. The company has decided to give six scholarships to young people to pursue their tertiary education. The company is fulfilling its
 - a) economic responsibility.
 - b) political responsibility.
 - c) social responsibility.
 - d) community responsibility.

4. A "line position" in any company
- directs subordinates in fulfilling the goal of the company.
 - gives support to the other positions
 - gives advice to managers regarding improvement of performance.
 - is usually shown with broken lines.
5. Which of the following statements describe the function of management?
- Making choices and decisions for the business.
 - Ensuring that the necessary resources are in place to accomplish the goals of the business.
 - Measuring and testing to ensure quality and standards are maintained.
 - Encouraging workers to be financially wise in their spending.
- (I) and (II) only
 - (II) and (III) only
 - (I), (II) and (III) only
 - (I), (II), (III) and (IV)
6. Which of the following department is responsible for
- checking and accepting goods purchased.
 - preparing reports on the goods received.
 - costing of new products.
 - maintaining an inventory.
- Accounts
 - Purchasing
 - Stock Control
 - Marketing
7. The term "MIS" means
- Management Initiation Systems
 - Management Information Systems
 - Marketing Information Systems
 - Manufacturing Instruction Systems
8. The management of Sonnyboy Media Company Ltd. has decided to sponsor two employees in Production of Radio and Television Broadcasting courses.
Which obligation is the company fulfilling?
- Obligation to society
 - Obligation to employees
 - Obligation to government
 - Obligation to owners

9. The manager whose responsibility it is to provide a working schedule of workers is the
 - a) Production Manager.
 - b) Human Resource Manager.
 - c) General Manager.
 - d) Finance Manager.

10. Delegation of authority means that
 - a) a group of trade union members holds power.
 - b) workers are responsible for planning their schedules.
 - c) the supervisor has given some of his tasks to subordinates.
 - d) top management is allowed to give orders to followers.

11. Which of the following is NOT a benefit of MIS?
 - a) It improves communication and decision making
 - b) It provides timely and accurate information.
 - c) It reduces labour costs.
 - d) It reduces productivity.

12. An organisational chart is
 - a) a visual representation of the relationships between departments.
 - b) a diagram showing levels of hierarchy.
 - c) a chart indicating informal relationships.
 - d) a diagram showing areas of centralisation.

13. The term used to describe the division of tasks is
 - a) chain of authority.
 - b) centralisation.
 - c) work specialisation.
 - d) span of control.

14. The information technology department in an organisation has a _____ relationship.
 - a) line
 - b) staff
 - c) supportive
 - d) functional

14. Which of Maslow's hierarchy of needs theory deals with love and belonging?
 - a) Physiological
 - b) Security
 - c) Social
 - d) Status

15. Which of the following is NOT true of a narrow span of control?

- a) It increases management cost
- b) It allows for greater control of activities
- c) It causes closer individual supervision to occur
- d) It provides immediate feedback to subordinates

(Section B Total: 15 Marks)

When you are finished this assignment, submit it to your tutor for evaluation. You may be asked to include the session assessments you have completed and self-marked.

Total: 40 Marks

Unit 7: Leadership, Teamwork and Communication in Business

Introduction

Most people are aware of world renowned leaders such as Barack Obama, Fidel Castro and Nelson Mandela. In the business arena, leaders such as Donald Trump and Bill Gates have led their companies to great success. What makes a good leader? Is it the ability to influence and get the most productivity from people under their charge? Is it the skill to effectively communicate and promote teamwork? Or is it the ability to seize opportunities and overcome challenges that may inevitably arise?

Generally, the success of any organisation requires effective leadership, teamwork, communication and conflict management. In Session 1 you will examine three major types of leadership styles. Session 2 will introduce you to the value of teamwork in business organisations. In Session 3 you will focus on the communication process while in Session 4 you will explore how to manage conflicts that may arise in business organisations.

Upon completion of this unit you will be able to:



Outcomes

Explain three leadership styles commonly used in business organisations.

Explain the value of working in teams.

Describe the communication process used in business.

Recommend solutions to resolve conflicts that may arise in businesses.

The sessions in this unit are:

Session 1: Leadership in Business

Session 2: Teamwork

Session 3: Communication in Business

Session 4: Managing Conflict in Businesses

Time frame: Twelve hours (12 hours)

Session 1: Leadership in Business

Introduction

What comes to your mind when you hear the question “Who are leaders?” Most likely you will think of people who influence others and elicit their participation in certain activities. That’s correct. In Unit 6 you learnt about management and saw that managers have leadership roles. Do you believe that there is a difference between management and leadership? Are managers necessarily good leaders? What qualities define a good leader? By the end of this session you will be able to answer these questions.

In this session you will learn about three major leadership styles and recognise how each style or combination of these styles can be used in various business situations. You will also get a brief introduction to two other new styles of leadership that some organisations are now adopting in the hopes of stimulating creativity, increasing productivity and decreasing costs.

Upon completion of this unit you will be able to:



Outcomes

Define leadership.

Describe the qualities of a good leader.

Differentiate among autocratic, democratic and free reign leadership styles.

Recognise the advantages and disadvantages of each leadership style.

Recommend a suitable leadership style for given business situations.

Identify new trends in leadership styles.

What is Leadership?

Leadership is a process where an individual influences others to act in a desired way to accomplish a common goal.

The process of leadership basically consists of four elements:

1. A leader
2. Follower(s)
3. Communication between the leader and follower(s)
4. A situation

You will now briefly examine each of these elements of leadership.

A leader is the person who influences, guides or inspires others to act in a desired way. The success of a leader will therefore be measured by the ability to get people to act in the desired way. Being a leader is not always dependent on a title or formal authority. Some people are born leaders and naturally attract and easily influence followers, whether it is in a positive or negative way. Others learn to be leaders by acquiring skills through education, training and/or from experience.



Reflection

Think about any leader you know in your school, church or group to which you belong. What qualities does this person possess to inspire others to follow him/her?

You can check the qualities you identified with those stated below.

Qualities that define a leader include the following:

- Vision or foresight to set a goal that is to be achieved.
- The ability to plan, provide direction and delegate in order to keep others moving towards the goal.
- Effective communication skills to be able to share with others the importance of the goal and to make sure they understand what is required in order to achieve it.
- Knowledge, skills and expertise in relevant areas.
- The ability to motivate others to cooperate, participate and want to contribute their best towards achieving the goal.
- Generally, leaders who demonstrate personal attributes such as integrity, persistence, determination and enthusiasm serve as role models and are able to energise others and guide them to success.

Do these qualities remind you of the desirable characteristics of an entrepreneur and a manager, which you learnt about in previous units? Of course they do. So what conclusion can you draw from this comparison? Most likely you are thinking that entrepreneurs and managers are the leaders in business organisations. That is correct!

In businesses, the entrepreneurs and managers are generally considered to be leaders of the organisations. You will recall from Unit 6 that a business may have different leadership positions, such as directors, managers and supervisors. These people have positional authority and employees are compelled to do what these bosses order or direct. However, a manager who is a good leader is able to influence employees to work towards achieving goals because they want to, not because they have to. The style of leadership that managers use can determine the extent of support they get from employees. You will learn about leadership styles in the next section of this session.



Discussion

Many people think management and leadership are the same; do you agree with this? Discuss this with your classmates or tutor.

From your discussion you may have realised that both managers and leaders perform common functions, should possess similar qualities and are generally the same person. However, there is one fundamental difference between management and leadership. You can examine this in the table below.

Management	Leadership
Management focuses on managing resources to achieve the goals of the business.	Leadership focuses on influencing people in the organisation so they can be motivated to achieve the goals of the business.
Major functions of management include planning, organising, controlling, delegating and co-ordinating the activities of the business.	Leadership activities include persuading, motivating, inspiring, communicating, fostering interpersonal relationships, mentoring, training and influencing employees in the business.

Figure 1

You will realise that people cannot really be managed but they can be guided to go in the direction that a leader desires. Even though employees are one of the resources of a business, a different approach has to be used in dealing with them.

Why do you think this is so?

This is because people are not machines and consideration has to be given to their diversity in terms of values, beliefs and emotions. Thus people with responsibility for business organisations must both manage and lead to ensure success.

Sometimes there are informal leaders in an organisation. These are people who are able to influence others because of their personality traits within a framework of social and personal interrelationships. The informal leader's power does not come from the formal organisational structure but his/her influence over others; by using his/her influence, the informal leader can elicit or detract people from supporting those with formal authority.



Discussion

Cite an example of an informal leader from any organisation to which you belong. For example, at school is there a particular person that you and your friends trust and look to for advice and support, especially when decisions are made by the school authorities? Discuss the effects that this informal leader's influence can have over people who follow him/her, and how this can affect their response to decisions made by those with formal authority.

You will now examine the three main styles of leadership.

Leadership style refers to the behavior of leaders and the methods used to influence others. As mentioned previously, people and situations vary and there is no one best style. You may recall, as stated earlier, that managers may have to use different leadership styles for different situations in order to gain the desired results. The actual style of leadership used in a business organisation will depend on certain factors, which we will now identify. As you continue with your study of leadership styles, you will be given further explanations of these factors.

Factors influencing the leadership style used in a business:

- The nature of the task: A leader has to consider the type of task that needs to be accomplished. For example, is the task simple, complicated, routine or new? Does the task venture into uncharted areas?
- The amount of time available: Usually there may be a time frame to complete the task. For example, is completion of the task urgent, is it a crisis situation that requires an immediate response, or is there sufficient time to plan a course of action?
- The knowledge, skills and abilities of the leader and followers.
- The accessibility to information required: This refers to what and how much information is available, who has it and who has to get it.
- The nature of interpersonal relationships in the situation: For example, is there mutual trust and confidence among persons? Is the situation one that gives rise to high stress levels? Are there internal conflicts and unresolved issues among persons?

These are some of the major factors that impact the leadership style that one can use. This in turn affects the extent and nature of influence that a leader has over followers.

You will now examine three main leadership styles: autocratic, democratic and laissez faire.

1. Autocratic leadership

In this style of leadership, all authority and decision making powers are centralised in the leader. He/she seeks to dominate all situations. This person is described as an authoritarian or autocratic leader. Communication is one-way, going down from the leader to followers. He/she does not permit subordinates to make any suggestions, contribute to decision making or show any initiative. The autocratic leader demands obedience and tells employees or subordinates what must be done, how it should be done, and then closely supervises all activities. There is little or no opportunity for employees to provide any response or feedback.

View the cartoon below which represents the autocratic leadership style:



Image drawn by: Jean-Marc Hills Ministry of Education DEU

The autocratic leadership style is commonly used in the military but is sometimes necessary in certain business situations.



Activity

Identify at least two examples of situations in a business when it may be necessary for the leader to use an autocratic style of leadership. Justify your choices using the factors which influence leadership style as a guide. Share your responses with your tutor /classmates.

Examples of situations when the autocratic style of leadership may be necessary include:

- Crisis situations: Assume you are working in one of the nation's finest restaurants and a fire broke out in the kitchen. The manager immediately shouts a command for all employees to evacuate the building.

The manager's autocratic leadership style is acceptable in this crisis situation because it is urgent that all persons receive this important information. A command has to be given in the interest of saving lives and there is no opportunity for consultation or

feedback from followers. In urgent circumstances, people may want to be told what to do and the autocratic style of leadership may be preferable. The relevant factors here are limited time and the urgent nature of the task to be accomplished.

- Another situation in which autocratic leadership is permissible is in the training of employees who are now joining the business or being introduced to new systems of operations. In terms of accessibility of information and possession of knowledge, it is the leader who possesses the knowledge and has the task of sharing the information with the people who need it. The leader has to ensure that the relationship fostered will be one of mutual trust and respect so that employees will be motivated and responsive to the training.

Having looked at the autocratic leadership style, now turn your attention to one that is the extreme opposite: the laissez faire leadership style.

2. Laissez faire leadership

Laissez faire is a French phrase which means to allow others to do. A laissez faire leader allows employees to complete tasks on their own. This leader states the final goal that has to be achieved and delegates all authority and decision making powers to the employees. Another name for this leadership style is free reign because the leader gives the employees the freedom to organise themselves as they see fit. The leader provides no direction, supervision or feedback. The laissez faire leader expects employees to complete the delegated task on time as he/she is ultimately held accountable for its completion.

View the cartoon below to get an idea of how the laissez faire leader operates.

Go ahead and do
whatever you want to
complete the job while
I relax.



Image drawn by: Jean-Marc Hills Ministry of Education DEU



Discussion

Can you think of situations when the free reign style of leadership will be preferable and yield the desired outcomes? Share your suggestions with your tutor/classmates.

The free reign leadership style should be used carefully by leaders and is recommended in certain situations, which include the following:

- When employees are experts and possess the knowledge, experiences and skills to successfully complete tasks, and the leader has confidence in their abilities to do so.
- For situations of research and design where people are given free rein to conduct tests in an attempt to discover something new.
- For simple tasks that the leader trusts workers to perform without supervision. For example, a manager may allow the administrative assistants to decorate the offices for Christmas.

You are now familiar with the two extreme types of leadership: autocratic, where the leader dominates everything, and laissez faire, where the leader delegates everything. At this time you should be ready to examine a style that lies somewhere in between, and that style is known as democratic leadership.

3. Democratic Leadership

The democratic leader permits employees to participate in decision making, creating a “we” not “them” environment. He/she encourages employees to share their ideas on new and existing matters. Even though

final decisions are ultimately made by the leader, the employees feel like they are a part of the decision making process and are motivated to achieve the goals that are set. This is the reason why this style of leadership is also called participative.

The democratic leader delegates authority and responsibility to subordinates. Two-way communication is encouraged and employees are given the opportunity to listen and be listened to. This style of leadership fosters mutual trust between the leader and the employees.

View the cartoon below, which attempts to represent the co-operative and participative spirit of democratic leadership.

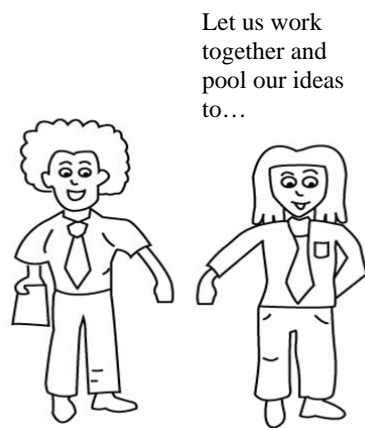


Image drawn by: Jean-Marc Hills Ministry of Education DEU

You can now attempt the following activity to get an idea of how more than one leadership style can be used in different situations by the same manager of a business.



Activity

Read the scenario below and answer the questions which follow.

You are working in an accounting firm where the software is obsolete. Fed up with the time delays, the manager informs the employees that the accounting software will be upgraded in two weeks' time. When this was done, three senior computer specialists were assigned the task of training all workers in the firm to use it while the manager went on vacation. When the manager returned from vacation, a meeting was held

to get feedback from employees on how they were coping with the new software. They were thanked for their support in successfully implementing the new system.

(a) Identify examples of the three types of leadership styles that were used by the manager.

(b) State whether you think the style used by the manager in each situation was appropriate, giving reasons to support your answers.

You can check the Learners Guide for answers or discuss your answers with your tutor.

From the above activity, you will notice that an effective leader can use all three styles depending on the situation, the nature of the task, the relationship between the leader and followers, and the knowledge and skills of the followers. People with responsibility for businesses are expected to be both good managers and leaders in order to ensure business success and highly motivated and productive employees.

Advantages and Disadvantages of Leadership Styles

Now that you are aware of the three main leadership styles, you will examine the advantages and disadvantages of each one.



Reflection

Your reflection on the following questions can help you to identify the advantages and disadvantages of the autocratic leadership style.

Have you ever been in a situation where the leader used an autocratic style of leadership? How did you feel? Would you use an autocratic style if you were a leader? In what ways do you think this would be effective? Can you foresee any problems you may encounter if this leadership style is used?

Check the table below for a summary of the advantages and disadvantages of the autocratic leadership style in business situations.

Autocratic Leadership Style	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Since decision making is centralised in the leader, decisions take less time to be made and plans can be speedily implemented. This saving of time can increase efficiency, may lower costs and can contribute to increased profitability. • The issuing of orders and instructions is usually most effective in times of crisis or when it is necessary to prevent potential problems. Most employees welcome this style if it can save or improve the quality of their lives and the business environment in which they work. 	<ul style="list-style-type: none"> • When no opportunity is given for contribution to decision making, employees may not feel like a part of the organisation and this can negatively affect their sense of loyalty to it. • If employees cannot give ideas and suggestions, this can stifle their initiative and creativity. Both the employees and the organisation can be adversely affected. Employees may become frustrated, feel unfulfilled and lack the motivation to perform at their best. The organisation will miss out on valuable ideas that employees may have and can become less competitive. • The extreme control and supervision used by the leader might instill fear and create resentment in employees. This can negatively affect their morale and result in increased absenteeism and high labour turnover as employees may not want to remain working in that type of environment for very long. This can have a negative effect on the productivity and progress of the organisation.

Figure 2



Reflection

Consider the opposite situation to the autocratic leader. Would you prefer to be or have a laissez faire leader? Why or why not? Do you foresee any problems with this leadership style?

Now let us examine the advantages and disadvantages of the laissez faire leadership style presented in the table on the next page.

Laissez Faire Leadership Style	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Since employees are free to engage in decision making, they may be motivated to perform tasks and this can increase productivity in the business. • Employees are given the opportunity to work at their chosen pace; this may result in greater job satisfaction and improved morale and productivity. • Freedom given to employees to engage in research can stimulate creativity and result in the development of new and improved products. 	<ul style="list-style-type: none"> • The freedom given to employees to make all decisions may cause chaos in the business. The fact that the laissez faire leader does not provide direction can result in conflict. • Employees may have different ideas about how a task should be achieved. If there is no coordination, a lot of time and money can be wasted. • Some employees may not be disciplined enough to work without supervision and the freedom afforded them may result in unproductive time wasting. • The lack of supervision by a leader can result in problems and mistakes going undetected. This can create further problems which can be detrimental to the success of the business. • The fact that the leader does not provide feedback can de-motivate employees as they are unsure about the status of their performance. This can hinder their productivity.

Figure 3

Now you will get the opportunity to examine the advantages and disadvantages of the leadership style that lies somewhere between the extremes styles that you just studied. Look at the table below.

Democratic Leadership Style	
Advantages	Disadvantages
<ul style="list-style-type: none"> • When employees are consulted and given the opportunity to participate in decision making, this motivates them and increases their loyalty to the organisation. They tend to be more willing and committed to ensuring that the goals are successfully achieved. • The opportunity given to employees to contribute to decision making or give suggestions can promote initiative and creativity, thus helping the business to progress. • Alert supervision and monitoring can help in detecting potential and/ or actual problems so proactive and corrective measures can be taken in a timely manner. This can improve the performance of the business. • Delegation of authority and responsibility assists with successful planning for the business. This ensures that there will be employees who have the opportunity to acquire necessary skills and experience to fill vacancies when they arise. 	<ul style="list-style-type: none"> • The opportunity given to employees to participate in decision making can be time consuming. As a result, decisions may take a longer time to be made and there can be a time lag in the implementation of plans.

Figure 4

The mere fact that the points in the advantages column far exceed those in the disadvantages column indicates that the democratic leadership style is the most preferable one. However, it is important for you to remember that an effective leader varies the style of leadership to suit

different situations, thus achieving the preferred influence for successful achievement of desired goals.

In recent times, the need to foster development, empower and encourage participation of employees has become more popular. Many leaders are adjusting their leadership style to get the best from employees while keeping them motivated and comfortable in an environment that places some emphasis on their social needs. This is evident in the paternalistic and team-based approaches to leadership.

New trends in Leadership

Paternalistic leadership style

This is an enhancement of the autocratic leadership style. It is based on the idea of the leader as a father figure who is in a position to know what is best for the organisation and the followers.

In the paternalistic leadership style, the leader basically makes all decisions, gives directions and closely supervises the activities of employees. However, he/she pays attention to the welfare of employees and attends more to their social needs. This may be done by organising health care plans, professional development training, and providing activities for leisure and socialising, such as family days and parties for special occasions.

Team based leadership style

This is where workers are empowered to do work by a leader by being organised into teams. He/she collaborates and shares vision and objectives with the team members. The team is empowered to accomplish specific tasks. This serves to motivate employees and foster positive relationships in the business. You will learn more about teamwork in the next session.

Session Summary



Summary

In this session you learned what leadership is, the qualities of a good leader and the advantages and disadvantages of different leadership styles.

The table below presents a summary of the salient points about the

different leadership styles in business organisations.

Leadership	Description	Advantage	Disadvantage
Autocratic	<p>Leaders make all decisions, directs and supervises all activities</p> <p>Does not allow employees to give ideas or participate in decision making</p>	<p>Quick decision making</p> <p>Useful in crisis and emergency situations</p>	<p>Employees may lack motivation to work</p> <p>Stifles initiative and creativity of employees</p>
Democratic	<p>Leaders encourage employees to participate to decision making</p> <p>Leaders delegate authority and responsibility to employees</p> <p>Two-way communication between leaders and employees is encouraged</p>	<p>Employees who are allowed to make decisions may be more motivated and feel a greater sense of loyalty to the business, resulting in increased productivity</p> <p>Employees may contribute valuable ideas and useful feedback to improve the business</p>	<p>Consultation with employees may be time consuming and final decisions will take longer to be made</p>
Paternalistic	<p>Leaders make decisions but also pay attention to the welfare and social needs of the employees</p>	<p>Workers are motivated to work as their social needs are met</p>	<p>Final decision making resides only in the leader</p>
Team based leadership	<p>Leader empowers workers by using teams</p>	<p>Motivation and empowerment of employees</p>	<p>Greater possibility of conflicts arising among team members</p>

Figure 5

Assessment



Assessment

Answer the following questions. You should spend twenty minutes on this assessment. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

- (a) The Board of Management at Rio Claro Beach Resort has informed all department managers that they should adopt a more democratic style of leadership instead of the autocratic style that is presently being used. Identify two differences between the autocratic and democratic leadership styles. (4 marks)
- (b) Suggest two strategies the managers should use become more democratic leaders. (4 marks)
- (c) Describe TWO benefits that may result from employing a democratic leadership style at the Rio Claro Beach Resort. (4 marks)

Total: 12 Marks

Session 2: Teamwork

Introduction

A recent global trend in most business organisations is the concept of teamwork as a means of improving morale and productivity.

Suppose your teacher elected you to be the coordinator for a team project presentation. What would you do to get your team members to co-operate and successfully complete the project?

In this session you will learn about an effective team, recognise the steps in team building and examine the importance of teamwork in business organisation.

Upon completion of this session you will be able to:



Outcomes

Define what a team is.

Describe the characteristics of an effective team.

Explain the steps in team building.

Assess the importance of teamwork to businesses.



Terminology

Synergy:

A joint effort among departments, persons, and businesses or suppliers in order to perform tasks to create value or benefits.

What is a team?

A team is a group of people with multiple skills and experience who come together and are committed to achieving a shared goal.

In a business, teams may be formed within the given organisational structure, as well as for special projects or tasks.



Figure 6: Picture showing the West Indies Cricket Team



Reflection

From mid-1970 to early the 1990s, the West Indies Cricket Team (WICT) emerged as winners for both Test and One Day International cricket.

What do you think accounted for the success of this team?

Did you identify any of the following as reasons for the WICT's success?

- Skills and experience of team members as batsmen, bowlers, fielders and wicket keeper.
- A shared goal or desire to win and maintain West Indian pride and glory.
- Effective collaboration among the selectors, cricketers, managers and coaches.
- Synergy among team members.
- Effective strategic planning on how to play the match.

These characteristics are essential for an effective team. You will now examine these in the context of businesses.

Characteristics of an effective team

Positive interrelationships among team members: This is important so people can feel comfortable with each other and communicate easily. It may also prevent conflicts, undue stress and tension which can have a negative effect on achieving goals. However, in any organisation disagreements are inevitable, and when they arise team members must find creative ways to resolve them. You will learn more about conflict resolution in Session 3 of this unit.

Shared goals or objectives: All team members need to have a united purpose to work towards. There must be free discussion of objectives in an atmosphere that is informal, comfortable and relaxed. From this, each team member will have meaningful and clear roles to follow, which will lead to the successful achievement of overall goals.

Commitment from all team members: Each team member must realise the importance of his/her contribution and should aim to meet or exceed the expectations of other members. They must all be respectful of the rules which govern the operations or dynamics of the group. This includes arriving on time for meetings, being prepared, persisting when setbacks arise and completing tasks agreed upon at the scheduled time.

Expertise of team members: Each member should possess knowledge, skills and experience in the relevant areas. Each team member must be respected and valued for the unique contribution made. Skills of members should also be complementary and add value to the group effort. This will serve to energise, motivate and contribute to success.



Reflection

Reflect on the WICT as an example in the mid 1970's to early 1990s. Do you think that the team's multiple capabilities allowed them to gain an advantage over difficult issues and also in competition?

If you said yes, you are correct. In that era of the WICT success, each member of the team was respected and valued for his knowledge, skills, experience and contribution made towards the team's success.

Collaboration: All team members must be actively involved in working together, sharing ideas, discussing, communicating and building consensus to increase the success of the team. Teams that work together tend to work harder and achieve a lot more in a shorter period than people who work individually. For example, team members jointly deciding upon a strategy for obtaining additional funding will have a better chance of achieving their goal, as opposed to a person working on his/her own.

Existence of trust: Webster's Dictionary defines trust as the "assured reliance on the character, ability, strength, or truth of someone or something." In businesses, managers group people into teams. However,

managers need to choose team members carefully so that they will trust and support each other as they work together. As trust is essential in creating a healthy working environment, so team members will feel confident if they can rely on each other.

Establishment of milestones: Based on the established goals, milestones with achievement targets and times should be set. These will be used to measure the extent of success. These small achievements should be celebrated and members praised publicly for their efforts. This will help to foster improved morale among team members.

Sometimes business teams may be formed for special projects and may be made up of employees from departments in the organisational structure. You will now examine this.

Teams for special projects

A special project team can be created for both long term and short term tasks.

An example of a long term project may be the development of a new product. The team to pursue this goal may be made up of persons such as:

- The product designer from the production department
- A costing clerk from the financial department
- A marketing researcher and feasibility analyst from the marketing department
- A logistic clerk from the logistics department

You will notice that this team is a combination of various skilled persons from across the organisation. This team relies on the expertise of each member to successfully achieve its goals.



Discussion

A common trend in businesses today is the hosting of Family Day events. Some businesses may use external professional event planners, while others will use the expertise of staff within the organisation.

Discuss how a business can successfully implement a Family Day using only its staff.

Refer to the Learners Guide for points relevant to this discussion.

Team building

Team building refers to a process used to form effective working groups or teams. Recall that the aim of a team is to bring people of multiple skills together to achieve shared, common goals. This is useful in improving productivity and motivation among team members.

Tuckman (1970) suggested a five stage model for teambuilding. He also stated that each of the phases in the 5 stage model are necessary in order for teams to grow, face challenges, tackle problems, find solutions to problems, plan work and deliver results.

These are:

- 1) Forming
- 2) Storming
- 3) Norming
- 4) Performing
- 5) Adjourning

You will now briefly examine each of these stages.

Tuckman's five stage model for teambuilding

1) Forming

In this first stage, the team is formed as members meet. There is great reliance on the leader, who has to provide guidance and direction on the purpose and objectives of the team. Team members are still unclear about their individual roles and responsibilities and may ask many questions.

2) Storming

In this second stage, team members compete with each other to gain influence and establish themselves. There may be conflicts among cliques that may develop. The leader has to establish a leadership style and guide members to acceptable team behaviour and clearly defined roles.

3) Norming

By this third stage team, members have established a sense of unity and purpose, with mutual trust, understanding and respect as they begin to work towards the common goal. Open communication increases as the leader encourages participation among team members. As trust develops, he/she may share some leadership roles with others.

4) **Performing**

At this fourth stage, the team is self-directed and highly motivated. All team members are working in harmony towards the achievement of the common goal. Any conflicts which arise are amicably resolved within the group. The leader now acts as a facilitator and encourages personal and interpersonal development of team members.

5) **Adjourning**

This fifth stage is not part of developing the team but is essential to allow members to celebrate their success at achieving the goals. Team members will feel good about themselves as they move on to new ventures equipped with the skills and experiences gained. This may be an emotional experience for teams that had a close bond among members. It is important for the leader to express gratitude and to recognise both individual and team efforts.

Importance of teamwork to businesses

Teamwork is a collective effort by a group of people who subordinate their personal interests in order to unite and accomplish a desired task.



Figure 7

Source: Ministry of Education DEU



Discussion

Look at the illustration below. What does it suggest to you about the importance of teamwork? What are some ways in which teamwork can be beneficial to employers and employees? Discuss this with your classmates and/or tutor.



Figure 8

You will now examine the value of teamwork to employers and employees in a business organisation.

Look at the table below for a complete summary of the value of teamwork.

Value of teamwork to employees and employers of a business

EMPLOYEES	EMPLOYERS
Have a sense of purpose and a feeling of belonging which makes them comfortable and increases their productivity.	Have more self-directed productive teams, which should result in improve business performance.
Develop their expertise from working with the experienced and knowledgeable team leader and other team members.	Benefit from the expertise of the team, resulting in increased efficiency and profitability.
Find that working collaboratively is much	Obtain increased output in less time and may have cost

EMPLOYEES	EMPLOYERS
easier than working alone and much more work may be completed in a timely manner.	savings.
Are energised and motivated to achieve their full potential.	Gain a highly motivated and dedicated staff and benefit from low staff turnover.
Find it easier to communicate by sharing ideas and encouraging feedback from leaders and other team members.	Benefit from the positive and harmonious environment created by two-way communication.

Figure 9



Discussion

Now that you are aware of the value of teamwork in a business environment, do you think that there are disadvantages of working in teams?

Discuss this with you classmates or tutor.

Compare the points you raised with those stated in the Learners Guide.

Session Summary



Summary

In this session you learnt about teams, teambuilding, teamwork and the benefits of teamwork in a business.

- A team is a group of people coming together with skills, experience and commitment to achieve a shared goal.
- An effective team has the following characteristics:

- ✓ Positive interrelationships among team members
 - ✓ Shared goals or objectives
 - ✓ Commitment by all team members
 - ✓ Expertise of team members
 - ✓ Effective collaboration
 - ✓ Trust among team members
 - ✓ Established milestones to measure the extent of success
- Team building refers to a process used to form effective working groups.

The five stages of teambuilding are:

- 1st stage: Forming
 - 2nd stage: Storming
 - 3rd stage: Norming
 - 4th stage: Performing
 - 5th stage: Adjourning
- Teamwork is a collective effort by a group of people who subordinate their personal interests in order to unite and to accomplish a desired task.
 - Both employers and employees enjoy advantages from use of teamwork in a business organisation.
 - Disadvantages of teamwork include:
 - Time-consuming: The formation of an effective team may take a lot of time before the benefits of their contribution can be realised.
 - Conflicts: When different people come together, conflict and disagreements are inevitable. This may delay decisions and adversely affect interpersonal relationships in the organisation.
 - Domination by a few: Sometimes one or two team members may dominate the discussions and not allow others to make valuable contributions.

- Lack of co-operation by a few: Team members who lack a co-operative team spirit may fail to perform their individual tasks, which could hinder the achievement of the team.

Assessment

Write answers to the following questions. You should spend at least twenty minutes on this assessment.



Assessment

John and Jack operate a partnership in Trinidad and Tobago that produces components for the computer industry. Increasing demand for these components has caused the business to grow. It now employs an additional thirty (30) persons. John and Jack are considering building high performance teams to help manage the growth in the business.

1. What is a team? (2 marks)
2. Suggest two types of teams that can be formed in Jack and John's business. (2 marks)
3. Describe the steps that would be used in building the teams. (5 marks)

4. Discuss three advantages and three disadvantages of using teamwork in the business. (6 marks)

Total: 15 Marks

Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Session 3: Managing Conflicts in Business

Introduction

Conflicts are inevitable in organisations once different people are required to work together. If conflicts are not managed properly, there may be detrimental effects on the organisation.

Suppose you were elected by your youth group to coordinate an after school brain cooler. For the project to be successful, you may have to form a team. What if you encounter a conflict with a member of the team? Would you know how to handle it?

In this lesson you will learn what conflict is. You will recognise the potential sources of conflict within an organisation. In addition, you will be introduced to strategies that can be used to manage conflicts.

Upon completion of this session you will be able to:



Outcomes

Explain what conflict is.

Identify potential sources of conflict within an organisation.

Describe strategies used to manage conflict within an organisation.



Reflection

How would you define conflict?

Can you recall an incident when you and a good friend did not share a common point of view?

You may have fallen out over the issue and eventually got together to try resolve the disagreement. This situation describes a conflict and an attempt at managing it.

A conflict can be described as a fight or quarrel among individuals or groups that differ in attitudes, values or needs. A quarrel exists when there is a refusal or failure to agree or there is a difference of opinion among persons.



Figure 10

Source:

http://adminsecret.monster.com/nfs/adminsecret/attachment_images/0002/5148/UnhealthyConflict_crop380w.jpg?1233091762

What do you think caused this conflict? Do you think this is an appropriate way to resolve a conflict?

Your reflection on this picture will be helpful as you now explore conflicts in business organisations.

Sources of Conflict

Conflicts occur from group activities in business organisations. These sources of conflict may arise within the organisation or with persons outside the business. You will learn of some internal and external conflicts that exist in businesses.

Some common sources of internal conflicts in a business organisation:

Style differences: Different people do things differently and this variation can cause conflict. For example, the advertising specialist likes to use a lot of graphic designs in advertisements but the general manager prefers simple and clear text messages.

Differences in leadership styles: You may recall that you learnt about different leadership styles. This may be a source of conflict as it may be challenging for an employee to cope with the varying styles in any given situation. For example, an employee who works different shifts may have different supervisors for each. One supervisor may be autocratic and the other democratic and dealing with these different styles may cause frustration and stress for the employee.

Differences in background and personality: People differ in ethnicity and gender. Also, each person has a different personality. This may be a source of conflict as the behaviour of people will be influenced by their environment, value system, beliefs, experiences and education. For example, an experienced female manager may have a different viewpoint than a new entry male manager when it comes to modifying the organisational structure of the business.

Unclear goals and objectives: If goals and objectives are not clear, there can be misunderstandings and conflict as to how they should be pursued. For example, if a supervisor gives instructions for employees to produce 100 boxes but specifications are not given, then this is a potential source of conflict.

Unfair practices: Practices such as poor and unsafe working conditions, discrimination, and unfair treatment of persons are potential sources of conflict in an organisation. These can give rise to grievances and high labour turnover.

Lack of effective communication: Failure to transmit information clearly or to use the proper channels of communication can cause messages to be distorted and may result in conflicts. Another potential source of conflict occurs if a business does not encourage two-way communication.

Competition for resources among departments: All businesses face the economic problem of scarce resources. Allocating these resources to different departments can cause conflict since some may feel that the amount received is insufficient. Departments themselves compete against each other, and in their quest to excel, conflicts may arise.

Personal problems: Sometimes people may be facing personal issues, such as family problems, sickness, substance abuse or emotional problems, which may prevent them from doing their best.

Office romances can cause conflicts in organisations: Open showing of affection can make others feel uncomfortable. If the relationship is between superior and subordinate, there may be perceptions of

favouritism that may cause disagreements and possibly unethical behavior.

Some external causes of conflict in business organisations:

External forces in the business environment can cause conflicts within the business. Management may not have much control over these external forces. You will now examine some of these.

The economic situation: Changing economic conditions will affect most aspects of business operations. For example, in a recession there may be a fall in demand for goods and services. This will be a source of conflict as businesses will be forced to adjust to this situation. This may reduce the demand for inputs such as labour, which may cause conflict with labour representatives.

The political situation: Some government activities impact what happens in a business. For example, if the government reduces funding or granting incentives to businesses, it will negatively affect their operations. This can result in conflict as there will be a reduction in resources available for business.

Competition: Local and foreign competition from other businesses can affect what, how much and at what price a business can sell. This can be a source of conflict as it impacts the profitability prospects of the business.

Suppliers: The ability of suppliers to supply goods and services in the required amount, desired quality and at the given time can also determine whether or not conflict will arise in a business. For example, if a delivery is not made on time, it can cause delays which will negatively affect business operations and result in conflicts.

Special interest groups and public opinion: Sometimes public opinion and special interest groups may make statements or take actions that affect business operations and cause conflicts. For example, businesses that use animals for testing products may face criticism from animal rights groups. This will create conflicts within the business that uses animals for testing, as well as others that depend on the products made.



Discussion

Can you think of other possible causes of conflict?

Discuss your responses with your colleagues and tutor.

Dealing with Conflict

Sometimes conflicts may not necessarily have negative effects on a business organisation. When managed properly, conflicts can bring benefits. To avoid the negative consequences that can arise from conflicts, it is important for businesses to deal with them in a timely

manner or to take measures to prevent them. How a business deals with conflict will depend on its sources. Conflicts do not occur in a vacuum and information must be gathered on their source, frequency and the areas in which they arise. Being proactive in dealing with conflict is also important.

Proactive measures are actions taken in advance to prevent an incident from occurring. In a business, proactive measures that can be used in an attempt to prevent conflicts include the following:

Ensure that there is an effective communication system in the business. This means that information will be transmitted to the relevant people using the appropriate method. This will help to avoid conflicts, such as those which arise from people having unclear goals and objectives, insufficient information and no opportunity for feedback.

Put systems in place for persons to participate in decision making. This can be done through the formation of teams and adoption of measures to empower employees. This needs to be complemented by the existence of an effective communication system.

Organise professional development training for staff. This should include areas such as conflict resolution strategies, team building and fostering relationships with stakeholders. This will prevent problems that may arise from inter and intra-personal relationships in business organisations. It can also ensure unity of direction among everyone in the business organisation.

Develop a grievance procedure. This is a system that will identify steps to make complaints, hence allowing for grievances to be solved. This can also be used to inform management of potential conflicts so measures can be taken to avert them.

Some examples of measures to resolve conflict:

Dialogue: When a conflict exists, relevant parties should be allowed to discuss the matter so that the source of the conflict can be identified. It is important at this stage to deal with the facts in a respectful and rational manner. Sometimes from this discussion, a solution can be found. If at this stage there is no resolution to the conflict, then mediation should occur.

Mediation: An impartial or neutral third party is invited to guide the involved parties to an agreement. The mediator will try to establish common grounds or points of agreement between the parties with the object of getting them to reach a compromise. This process is an informal discussion and is non-binding. If it fails to resolve the conflict, the parties involved can seek conciliation.

Conciliation: This process is similar to mediation except that the neutral third person meets separately with the parties involved in the conflict.

The main goal is to seek concessions to resolve the conflict. If this fails, the next step is arbitration.

Arbitration: At this stage, the neutral third person, after carefully reviewing the arguments of both parties, gives a decision to resolve the conflict. This decision is legally binding.

All the stages identified above describe the grievance procedures that are generally established in business to deal with conflict. Some conflicts may be industrial disputes. This means that the conflict is between employer and employees over issues such as pay, working conditions, terms of employment and discipline. In this case, the employees seek representation from a trade union. You will now learn about trade unions.

Trade Unions

In most countries, the agency which exists for representing employees in the work place is called a trade union. The trade union uses the process of mediation and operates as the link between employers and employees.

A trade union is an organisation of workers joined together to achieve common goals in the interests of employees in the work place. In each unionised workplace, a shop steward is elected by the trade union members to represent them. The shop steward is thus the first level of union representation in the workplace.

Main aims of a trade union:

- To secure improved wages for workers
- To negotiate for better working conditions, including working hours
- To bargain for job security and better welfare benefits, such as illness and retirement plans
- To represent workers in resolving conflicts they may have with employers
- The trade union uses the collective bargaining process in an attempt to secure the first three aims mentioned above. The grievance procedure is used for the fourth aim, which is to resolve conflicts.

Collective bargaining

Collective bargaining is a process of negotiation between representatives

of employers and employees. The representative of employers is usually the human resource manager while the representative of the employees is a committee of shop stewards and trade union officials. These representatives come together to discuss and resolve issues such as conditions of employment, rates of pay and welfare benefits. All agreements reached between them are legally binding and usually cover a specified period of time.

Grievance procedure

The grievance procedure consists of dialogue, mediation, conciliation and arbitration. Recall that this was explained earlier in this session. When employees have a grievance with the employer, they can seek the assistance of the trade union to offer representation on their behalf. The trade union officials serve different roles in this process. At the dialogue stage, the shop steward represents the employees with the representative of the employer. For the stages of mediation, conciliation and arbitration, the union officials who are specialists in industrial relation matters represent the employees.

When negotiations between the representatives of employers and employees are not proceeding in the manner desired, the parties may take industrial action.

What is industrial action?

Industrial action refers to measures used by either employers or employees to exert pressure so that the demands are met.

Industrial actions of trade unions include:

- Some of the measures initiated by the trade union on behalf of the employees include work to rule, go slow, picketing and strikes.
- Work to rule is the form of industrial action in which workers do only what is stated in their job description. They do not do anything that will compromise health and safety regulations. For example, in a work to rule action in the transport industry, the drivers will refuse to drive defective or uninsured vehicles or to work overtime.
- Go slow is when workers engaged in industrial action do their job thoroughly but at a slower pace. With the previous example, the drivers will drive on the scheduled routes but very slowly. A journey that will normally take thirty minutes could take two to three times longer.

- Picketing is a form of industrial action in which workers hold placards and march outside the business to publicise their grievance and attract public support for their cause.



Reflection

Look at the picture below which shows workers engaged in picketing. Do you think this is an effective way for employees to force employers to give in to their demands for wage increases? Why? Do you think picketing can be useful for any other purpose?



Figure 11: Picture showing workers engaged in picketing

A strike is a complete withdrawal of labour by employees. The workers who are on a strike set up camps outside the entrances of the business to prevent scab labour from entering to perform their jobs. Scab labour refers to anyone who crosses the picket line to perform the duties of the striking workers. A strike is usually the last resort recommended by a trade union.

Industrial action of employers

The main measure an employer can use when taking industrial action is a lock out. In a lock out the employers lock their entrances, leaving the employees who are on strike outside. The employers usually claim that this is done to prevent their plant and machinery from possible sabotage from the striking employees.

Effects of industrial action

It is important for employers and employees to act responsibly when taking industrial action and to weigh the positive and negative effects of the action. This is important as it re-examines whether pursuing the industrial action is in the best interest of all who may be affected. Those affected include stakeholders such as suppliers to the business, customers of the business and the government.



Activity

Consider the positive and negative effects that industrial action can have on the stakeholders of a business. Use the table below to fill in your points.

Effect of industrial action on:	Positive effects	Negative effects
Employees		
Employers		
Suppliers		
Customers		

Figure 12

You can check the Learners Guide for the answers.



Activity

Look in your daily newspapers or electronic media for two reports of industrial disputes in a chosen country. For each report, you are required to:

- a) State what the dispute is.
- b) Identify the type(s) of industrial action taken by the employers and employees in each case.
- c) Whether or not the disputes were settled and what were the final terms of agreement.

Session Summary



Summary

In this session you learnt about what conflict and how businesses manage it.

- Conflict is a disagreement resulting from individuals or groups that differ in attitudes, values or needs.
- The sources of internal include:
 - Differences in leadership style
 - Differences in background and personality
 - Unclear goals and objectives
 - Unfair practices
 - Lack of effective communication
 - Competition for resources among departments
 - Personal problems
 - Office romances
- Suggestions for settling conflicts are:
 - Avoidance
 - Smoothing
 - Collaboration
 - Confrontation
 - Compromising.
- Measures used by employees to put pressure on employers are:
 - Strikes
 - Picketing
 - Work to rule

➤ Go slow.

• Measures used by employers to put pressure on employees are:

➤ Dismissal of workers

➤ Lock out workers.

• Industrial actions have possible harmful outcomes for employers, for employees and for the firm's customers. For example:

For employers:

- Loss of output and income
- Loss of customer
- Earn a poor reputation.

For employees:

- Wages lost
- Threat of losing jobs.

For customers:

- The need to find alternative supplier for the shortage of products or deliveries not made.

Assessment



Assessment

Answer the following questions to the best of your ability. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

Scenario:

Get Rich is an insurance company. It has seen profits falling slightly over the past three years. The management has decided to reorganise the departments and downgrade some of the jobs, that is, to cut costs by reducing wages. These changes were announced to the employees and they were not given the opportunity to discuss it. Some of the employees will have their salaries reduced and their job description changed. The employees are not happy.

- a) Why has conflict arisen in this situation? (2 marks)

- b) What could the workers and the employer do to resolve the conflict? (4 marks)

Trade unions use methods to protect the interest of its members. Explain how each of the following methods operate:

- a) Picketing (2 marks)

- b) Work to rule (2 marks)

- c) Go slow (2 marks)

Total: 12 Marks

Session 4: Communication in Business

Introduction

In today's society messages can be delivered all over the world instantly, over great distances and to a number of people at the same time. Due to the rapid developments in technology, methods of communication in businesses have changed drastically. You will learn more about these rapid developments in technology in Unit 9.

In this session you will learn about delivering messages and completing tasks through communication. However, in order to accomplish the latter, you will need to recall previous knowledge from Sessions 1, 2 and 3. These sessions dealt with leadership in business, teamwork and the managing of conflict.

In these sessions you learnt that in order to be a leader you must be able to communicate the goals of the firm and influence workers to achieve these goals. You will learn in this session about the communication process in business. In addition, you will learn about the roles that teamwork and conflict management play in this process.

Upon completion of this session you will be able to:



Outcomes

Define what communication is.

Explain the importance of effective communication in business.

Describe the communication flow in a business.

Describe the forms of communication used in businesses.

Discuss the advantages and disadvantages of each form of communication.



Reflection

Suppose that you are a Form Teacher of a class of thirty-five students and you decide to play a game with the students in your Home Room period. The game is called "Pass on the Message".

The entire class is asked to sit in the form of a circle and the game starts. The communication of the information to each student starts with

you, and each student will pass the message on to the next student. The message is:

“Good news there will be a staff meeting this Friday at 1.00pm... no classes...you are not going home.”

By the time the message gets back to you from the last student in the circle, the message is:

“Staff meeting today, you are going home half day.”

Why do you think the message was not clearly understood by all students?

Since the message was passed on from person to person, each one interpreted it differently and further passed on what they thought it was.

Was this an appropriate way to send a message of this nature?

If you answered no, you are correct because by the time the message came back to you, it was distorted.

You will now learn about communication.

What is Communication?

Communication is the process in which information is transmitted by a sender to a receiver through some medium.



Activity

Identify the key terms stated in this definition of communication.

Did you identify: process, information, transmitted, sender, receiver and medium? Well done.

You will now examine the communication process.

A process is the act of taking something through a routine to convert it from one form to another. Thus in communication, a process exists because a message or information goes from a sender, through given channels to be interpreted by a receiver, who then has the option to give feedback.

The diagram below shows the communication process.

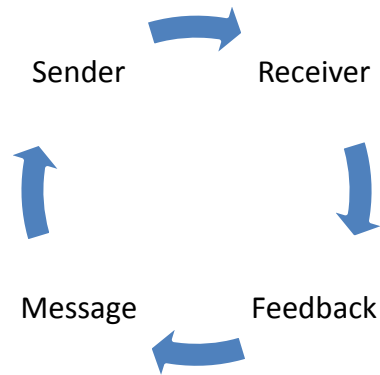


Figure 13

You will now examine each element of the communication process.

The sender of a message formulates and encodes the information to be sent, considers the possible barriers that may affect the message, chooses the channel or medium to be used, and then sends the message.

The message is the information that is sent. It should be clear so that it can be received in the manner intended, without any misinterpretation.

The receiver in the communication process is the person who gets the message and has to understand or make sense of it.

Feedback is the response the receiver gives to the message of the sender. This indicates whether or not the message has been received as intended or if it has to be altered by the sender to achieve the desired result.

You will notice that in the reflection done at the beginning of this session, the feedback indicated that the message was not received in the manner intended. Thus communication was ineffective.



Activity

Attempt the following activity.

Boyo informed Carol that he would not be in school the next day. He wants her to give him a copy of all the homework assigned by the teachers on that day. She told him that she would also not be in school.

From this scenario, identify the key elements of the process. Was the message correctly interpreted? Do you think the communication process was effective?

Check the Learners Guide for feedback on this activity.

You will now examine what makes communication effective.

What is Effective Communication?

Communication is effective when the message sent is received and understood in the manner intended and ample opportunity is given for feedback.

Communication will be effective if nothing goes wrong in any of the key elements of the communication process. It will be ineffective if barriers exist at any stage of the process.

Examine the table on the **next page** which shows factors that contribute to effective communication.

Key elements of the communication process	Factors contributing to effective communication
The sender	The sender has: <ul style="list-style-type: none"> - a clear idea and knowledge of the message to be sent - a positive attitude - shared knowledge and experience with the receiver
The message	<ul style="list-style-type: none"> - is simple, straightforward and unambiguous - language used does not contain jargon that the receiver may be unfamiliar with - is presented in the appropriate form, that is whether it is written, verbal, visual, electronic a combination of any of these forms
The channel	<ul style="list-style-type: none"> -is suitable for the nature of the message to be sent -enables the message to be delivered in the time required -is affordable -does not contain “noise” that will prevent transmission
The receiver	<ul style="list-style-type: none"> -is in the correct emotional and physical frame of mind -has no personality conflict with the sender
The feedback	<ul style="list-style-type: none"> -if ample opportunity is provided for it to be made -if the message is received and understood as intended

Figure 14



Activity

Use the same key elements given in the table above to brainstorm factors which may make communication ineffective.

Check the Learners Guide for the feedback on this activity.

Communication Flow in a Business

Effective communication is crucial to the success of a business. The flow of communication in a business may be internal and external. Internal communication exists among all the persons in the organisational structure. Externally, businesses communicate with suppliers, shareholders, government and customers.

Internal communication within the organisational structure can be vertical or horizontal. The organisational chart below shows the flow of communication in a typical business.

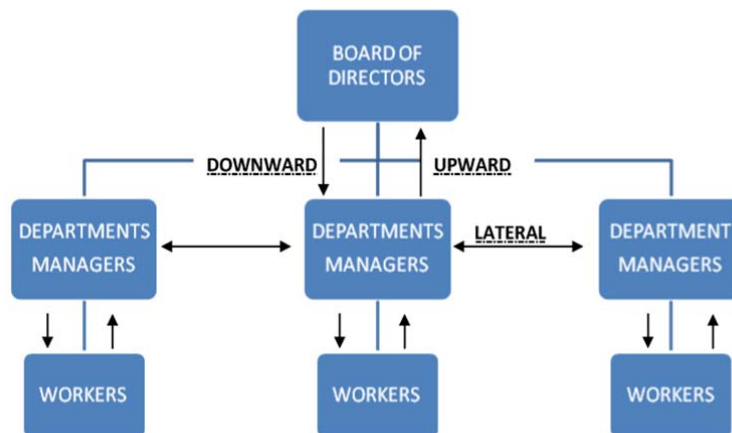


Figure 15: Diagram showing Communication Flow in a Business Organisation

Vertical communication in a business

Vertical communication can flow one-way or two-ways.

When communication is one-way and vertically downwards, information flows from a superior to subordinates and there is no opportunity for feedback. For example, in the diagram above, communication is one-way and downwards when department managers communicate with workers

and there is no opportunity for feedback. This is generally used to convey decisions that have already been made and to give orders to subordinates.

When communication is vertical and two-way, information flows downwards from superiors to subordinates and upwards from subordinates to superiors. Subordinates are given the opportunity to give feedback. For example, in the diagram above, two-way communication occurs between the Board of Directors and the Managers.



Activity

Identify other examples of two-way communication shown in the diagram above.

More and more businesses are using two-way communication. This results in the following benefits:

- Employees can participate in decision making and share ideas with management.
- Managers can receive feedback on decisions made and be alerted to existing problems. Fostering better relationships in the organisation which builds camaraderie and improves morale among all persons.

The diagram below illustrates vertical two-way flow of communication between management and employees of a business.

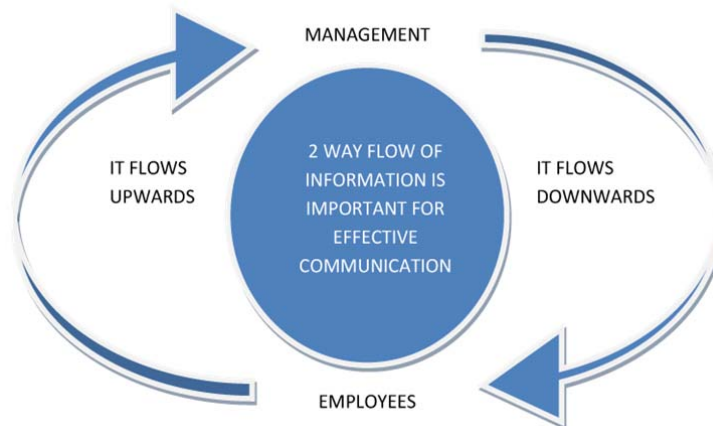


Figure 16: Diagram showing vertical two-way communication

Lateral communication in a business

Lateral communication occurs when there is flow of information among persons at the same level in the organisational structure. For example, in the diagram above, the lateral flow of communication is shown among department managers.

Forms of Communication

It is important for leaders to think carefully about the form used to convey messages. The main forms of communication are oral, written, visual and electronic transmission. You will now examine each of these.

Oral communication

Oral or verbal communication is the spoken word and may be formal or informal. Formal communication may be lectures, formal announcements or speeches. Informal communication may be a passing remark in the corridor, or speaking on a one to one basis. Other types of verbal communication may be interviews, group meetings, team briefings and appraisal sessions.

Written communication

Written communication is information that is a permanent record and is handwritten, typed or printed. Some types of written communication are memoranda, letters, reports, circulars, diagrams for technical matters, minutes of meetings, notices and advertisements. Each one of these written communication has its own unique features. The table below highlights some of these features.

Written Communication	Features
Memorandum or memoranda. Also known as “Memo”	This method of communication conveys information briefly. It is used internally in businesses. The format of the memorandum includes the names of the sender and receiver, the date, references (if any), a topic heading and a brief message.
Letters	Letters are used by a business both internally and externally. Internally, letters are used to convey personal information to employees, for example, to notify them about promotions. Externally, letters are used when transmitting information to individuals and/or other organisations. The main areas in this document are the date, a salutation, names and addresses of both the sender and receiver, body of the letter and a complimentary closing. Usually businesses have their own letterheads.
Reports	This document gives the full account of a particular topic or incident. It is normally a written formal statement. The report will contain the names of the writer and the person who requested the report, the date, data and/or facts and necessary recommendations.
Circulars	This is a document which provides general information to a number of people in the firm. The format includes the date, a subject heading, the message and the name of the sender. The names of the receivers are not stated but they are required to initial or sign the circular to indicate that they read it.

Written Communication	Features
Notices	A notice is a formal announcement that is placed in a public place, such as a notice board. It is intended for everyone to see.

Figure 17

Visual Communication

Visual communication is the use of images to convey information. These images may include pictures, tables, charts and graphs. They are normally used to accompany and support oral and written communication.

Electronic Transmission

This is the transmission of information via fax machines, computers, telephones, pagers, electronic notices, smart boards and answering machines. Electronic transmissions can include the other three forms of communication, which are oral, written and visual.

Session Summary



Summary

In this unit you learnt about the importance of effective communication in business organisations.

Effective communication is a process through which two or more persons completely understand the message sent.

The key elements of the communication process are the sender, the message, the channel, the receiver, and feedback. Communication is effective when the message sent is received and understood in the manner intended and ample opportunity is given for feedback.

The types of communication are verbal, written, electronic transmission, visual.

Assessment



Assessment

For this assessment, please complete the following question. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation. You should spend approximately twenty minutes on this question.

Your friend, who just graduated from hotel school, is planning to use his inheritance from his grandfather, to establish a guest house. He has come to you for advice on how to achieve effective communication in the business.

1. Identify the form of communication that could be used in the business. (2 marks)

2. Explain the internal flow of communication that will exist in the business. (3 marks)

3. Describe what he must do to ensure that communication is effective. (5 marks)

Total: 10 Marks

Assignment



Assignment

Please complete the following questions. You should spend thirty minutes on this assignment.

Sue-Ann, the owner of a fast food restaurant discovered that one of her managers has an autocratic style of leadership and was using abusive power. Sue-Ann preferred a participative style.

1. In a detailed paragraph, identify the key feature of an autocratic style of leadership. (4 marks)
2. What is meant by abusive power? (2 marks)
3. Identify the key feature of a participative style of leadership. (2 marks)
4. State two possible causes of conflict in an organisation and explain how each can negatively impact the business environment. (4 marks)

Unit 8: Contracts in the Business Environment

Introduction

In the business environment all over the world, people enter into business transactions, which can sometimes be classified as contracts. Some examples may include buying a newspaper or snacks, hiring a taxi, taking out a loan, paying wages to employees or purchasing stocks for sale. What is common amongst these transactions? Are you thinking that people have needs to be satisfied and require assistance of others to do so? That is correct. Additionally, these transactions have an underlying agreement which requires people to promise to give and receive something from each other. What makes these agreements contracts? The answer lies in the fact that they give rise to legal obligations.

The study of contracts can be wide ranging and complex. For the purposes of this course, this unit will briefly focus on contracts in the business environment and how they can impact people as employers, employees, consumers and sellers. Session 1 will introduce you to the basic principles necessary for the formation of a contract. In Session 2 you will learn about two major types of contracts namely, simple contracts and specialty contracts. Session 3 will give you an insight into how contracts can be terminated. You will also be given the opportunity to examine simple case studies of business transactions in order to apply what you learnt about contracts.

Upon completion of this unit you will be able to:



Define the term “contract”.

Describe the basic principles of a contract.

Distinguish between simple contracts and specialty contracts.

Explain how contracts are terminated.

Apply the principles of contract to case studies.

The sessions in this unit are:

Session 1: Basic Principles of a Contract

Session 2: Simple Contracts and Speciality contracts

Session 3: Termination of Contracts.

Session 1: Basic Principles of a Contract

Introduction

What do you think is common to actions such as purchasing goods, paying for services, hiring someone to perform a job or even taking out a loan? Did you recognise that these actions have an underlying agreement which requires the persons involved to give and receive something from each other? That's correct. An agreement is essential when making decisions. In the business world, agreements that give rise to legal rights and obligations for the persons involved are called contracts.

In this session you will learn about the essential principles which form the basis of a contract. Additionally, you will acquire knowledge to be able to identify whether or not a contract is valid.

Upon completion of this session you will be able to:



Outcomes

- *Define* the term “contract”.
- *Distinguish* between a contract and an agreement.
- *Describe* the basic principles of a contract.
- *Determine* what makes a contract valid.
- *Explain* what makes a contract void.
- *Identify* the difference between an offer and a counter offer.
- *Distinguish* between a valid contract and a void contract.
- *Explain* the concept of invitation to treat.



Terminology

Contract:	A legally binding agreement between two or more parties for an action to be performed by one or both parties.
Laws:	Rules of conduct governing a state or nation enforced by the threat of punishment if violated.
Offer:	A clear proposal made by one party to another party, for acceptance or rejection.
Acceptance:	When one person agrees to an offer or proposal made by the other party.
Consideration:	Something of value promised by one party to the other in order to secure mutual performance of the desired actions.
Bid:	The price at which a business or individual is prepared to buy.
Transaction:	A legally binding agreement, contract, exchange or transfer of cash or any property that occurs between two or more parties.
Precedent:	Past events which serve as examples or rules for future events.
Offeror	The person who makes an offer.
Offeree	The person to whom an offer is made.
Valid contract	A contract that is valid and legally enforceable.
Void contract	A contract is declared void or invalid if any of the principles necessary for a valid contract is not present or is violated.

What is a Contract?

A contract is a legally binding agreement that gives rise to certain rights and obligations for the parties concerned. This means that those who have made the agreement are compelled by law to carry out the promised actions or intentions.

What is an agreement? An agreement exists when there is mutual understanding among parties to perform an action. For example, your parent may agree to give your friend a free ride to school daily. There is no legal obligation to perform this act. It is simply an agreement to do a good deed that your parent is performing. If your parent is unable to provide the ride, your friend cannot take legal action to compel him/her to do so.

When an agreement can compel the parties to perform the agreed intentions or actions, it is said to be legally binding. A legally binding agreement provides the basis for the formation of a contract which creates certain rights and obligations.

For example, if your parents purchased a car, the seller is under a legal obligation to supply it in accordance with the terms and conditions agreed upon. Similarly, your parents are legally obligated to pay for the car and to get the rights to its ownership.

If these obligations are not performed by either party, legal action can be taken. The legal action can compel the party to perform the action or to provide compensation for losses suffered due to non-performance of the agreed action. You will learn more about this in Session 3 of this unit.

A contract is thus more than an agreement and it is based on laws. Laws exist in all countries and dictate what persons can and cannot do. Laws are designed to be accepted as a code of conduct by everyone. Their aim is to ensure that individuals, businesses, governments, and even you, work within an established legal framework. Basically, there are two types of laws: statute law and common law. Statute law refers to rules legislated by Acts of Parliament. Common law or case law is made by judges through decisions of the court and sets the precedent for future behaviour.

You will now focus on the basic principles necessary for the formation of a contract.

Basic Principles of a Contract

The basic principles that must be present for formation of a contract are offer, unconditional acceptance, consideration, legality of purpose, capacity of parties, genuine assent and possibility. These will now be explained and illustrated with examples from the business environment.

Principles necessary for formation of a Contract

1. Offer

An offer is a clear proposal made by one party, called the offeror, to another party, called the offeree. The proposal states the terms and conditions the offeror is willing to make and be legally bound by. For

example, it may be to sell something, to perform a task or to hire someone.

The following guidelines should be observed for an offer:

- An offer should be clear, concise and complete so there is no misinterpretation of its terms.
- An offer should be a statement of intention to create a legal obligation.
- An offer may contain conditions attached to it but these must be outlined to the offeree.
- An offer may have a specified time period after which it will terminate.
- An offer may be withdrawn or revoked before it is accepted.

2. Acceptance

An acceptance occurs when the offeree agrees to the offer or proposal made by the offeror. The offeree then becomes the acceptor. Acceptance of an offer sets the framework for pursuing the other necessary conditions so that a contract can become finalised.

The guidelines governing acceptance are:

- Acceptance must be unconditional. This means that there must be agreement with the exact terms and conditions stated in the offer. No conditions must be added by the offeree to the offer that was made. If conditions are stated by the offeree, a counteroffer is made and the offeror may reconsider the offer. You will learn more about counteroffer later on in this session.
- Acceptance must be made within the time period that the offeror has specified.
- Acceptance must be communicated to the offeror by the offeree.

The diagram below shows an example of two parties involved in an offer and acceptance.

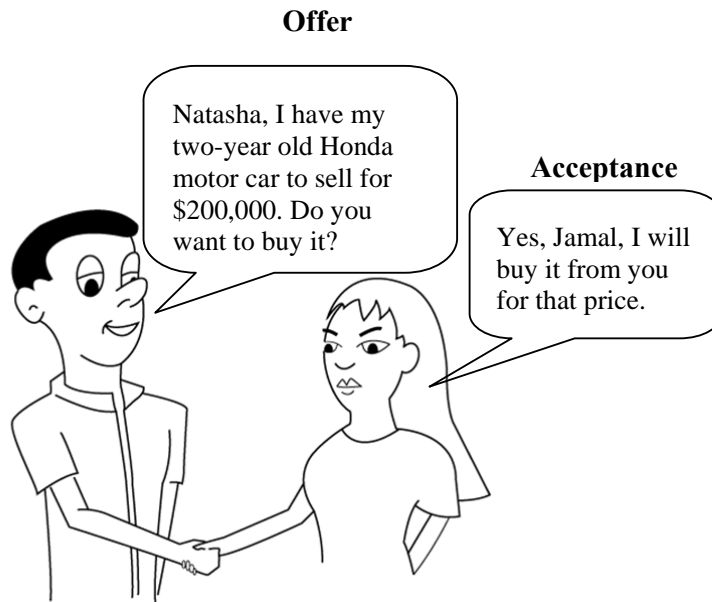


Figure 1

From the diagram above, Jamal is the offeror and Natasha is the offeree and acceptor. Let us now look at what consideration is.

3. Consideration

Consideration is an essential element for the formation of a contract. It is something of value promised by one party to the other in order to secure mutual performance of the desired actions. Consideration can take the form of money, physical items, services, promised actions and an agreement not to do certain things in the future.

Review the example above of the offer and acceptance between Jamal and Natasha. Consideration is the price of \$200,000 that Jamal offered to sell the car for and the amount of money that Natasha agreed to pay. The value of money agreed upon by both parties serves as a promise and encourages them to enter into a legally binding agreement to secure the performance of selling and buying of a motor car.

Please note the difference between a promise and performance: A promise is an assurance that someone will or will not perform an act in the future, while performance means that the act is performed or done by the person(s).

The following guidelines should be observed for consideration:

- Consideration must be real and adequate. This means that the consideration to be exchanged must be specific and have a measurable financial/interest value to the offeror and offeree.

For example, in the diagram used earlier on in this session, the amount of money that Jamal will receive and the car which Natasha will get illustrate that consideration is real and has measurable value which is beneficial to both parties in the contract.

- Consideration must be present. This means that consideration must not be a promise for an act that has already been performed. This will ensure that benefits can be gained from the parties who are presently entering the contract.

4. Legality of purpose

All contracts must be in conformity with the laws or legal regulations of the relevant country. For a contract to have legality of purpose, the conditions agreed upon must not violate existing laws. If there is violation of laws, then illegality of purpose exists. Generally laws were created to regulate, control and protect all stakeholders from illegal practices.

An example of illegality of purpose would be if Person A promises to pay Person B to steal a gold necklace. This promise cannot form the basis for a legally binding contract because stealing is illegal. If Person B receives the money and does not deliver the gold necklace, Person A will have no legal recourse because there was illegality of purpose.



Reflection

Refer to the first diagram of this session. Do you think there is legality of purpose in the transaction made between Jamal and Natasha?

Yes, there is, as it is legal for someone to sell a car to another person.

Can anything make this transaction illegal? Yes, for example if the car did not belong to Jamal and was stolen, then there would be illegality of purpose. What do you think is the reason for this? In addition to recognizing that stealing is against the law, you are correct if you said that selling stolen items is illegal.

5. Capacity of parties

Both parties entering a legally binding agreement should have the capacity or be eligible to do so. Capacity of parties means that persons

have the ability to fully understand the implications and consequences of the contract and can take full responsibility for their actions.

Persons who have capacity to make contractual arrangements include the following:

- Persons of sound mind: This refers to persons who are mentally and emotionally able to weigh the pros and cons of a situation and make an objective decision. It excludes persons who may be medically declared emotionally unstable or insane.
- Persons who are not under the influence of drugs or alcoholic substances.
- Persons excluding those above, who have attained the “legal age” and can be classified as adults. In most countries, this is usually 18 years and people below this age are considered to be minors.

From our first example above, both Natasha and Jamal are assumed to have capacity, which was critical in the making of a contract.

It is important to note that in certain circumstances minors are recognised as having the capacity to make contractual arrangements. These are usually restricted to the purchasing of products, such as food and clothing, which are considered to be essential or necessary. Minors may also enter contracts regarding educational pursuits. However, where large sums of money have to be paid or borrowed, a signatory or adult, such as a parent or guardian, is required to co-sign the agreement to make it legally binding.



Discussion

Examine this scenario:

A 16 year old, part time working, high school graduate student needed funds to take a certified accounting technician course. The student decided to seek funding through a student loan. Unfortunately, the student was not successful in getting the loan from the financial institution because he/she was considered to be a minor.

Do you think this decision made by the financial agency was in keeping with the principle of capacity? Discuss this with your classmates.

6. Genuine assent

Genuine assent exists when parties entering a contract do so out of their own free will and in good faith. The terms and conditions of the contract

must not be clouded by fraudulent misrepresentation, duress or undue influence. Examine the meaning of these terms:

Fraudulent misrepresentation means that a person deliberately makes statements or engages in actions that are known to be untrue, improper or illegal.

Duress means that some force, threat or unfair advantage has been used to compel person(s) to enter into agreements to form contracts.



Discussion

Look at the following examples and discuss whether or not genuine assent is present:

- Example one: Jones steals a car, tells Mary he is the owner and sells it to her.
- Example two: Floyd pulls out a knife to make Lloyd purchase a pair of sneakers from him.

In example one, Jones has fraudulently misrepresented information to Mary.

In example two, Floyd has used duress to compel Lloyd to buy the sneakers.

In the above examples, one of the conditions necessary for the formation of a contract has been violated. Later on in this unit you will learn what action can be taken in such situations.

Do you think there was genuine assent in our illustration of Natasha and Jamal? It would seem so, because there is no evidence that there was any force or misrepresentation in the offer and acceptance.

7. Possibility

Possibility simply means that the parties of a contract must be able to do what is being agreed upon. For example, in our illustration, it must be possible for Natasha to get the stated sum of money and for Jamal to be able to pass ownership of the said car to her.



Reflection

Assume that Natasha gets the money to pay for the car; can you think of anything that can make this transaction impossible?

Suppose the car is stolen or damaged before the sale? Will it be possible for Jamal to do what was agreed upon?

Clearly, the answer is no. Sometimes circumstances may arise where the subject matter of the transaction no longer exists or is not in the same condition as when the agreement was made. Subject matter refers to the physical object(s) in the agreement. In our example with Jamal and Natasha the car is the subject matter. If the car is stolen, the subject matter no longer exists; if the car gets damaged, it is no longer in the same condition as when the agreement was made. This makes it impossible to carry out the obligations of the contract. In such cases, the contract will end and new terms and conditions can be negotiated. You will learn more about this in Session 3 of this unit.

What about if one of the parties should die before the transaction is completed?

In a case such as this, the legal representative of the deceased person can continue the transaction, so there is still a possibility that the transaction can take place.

With the example of Natasha and Jamal, you have seen that formation of a contract requires presence of the following basic principles: offer, unconditional acceptance, consideration, legality of purpose, capacity of parties, genuine assent and possibility. Once these principles have been fulfilled, the contract is described as being valid.

You will now take a brief look at some terms which were introduced in this section of the session, as well as a few new ones which often arise when contract law is being discussed.

Terms Used in Contract Law

A valid contract

In the previous section you learnt about the basic principles necessary for the formation of a contract. A valid contract is formed when these basic principles of offer, unconditional acceptance, consideration, legality of purpose, capacity of parties, genuine assent and possibility have been met. In a valid contract, the agreement made between the parties becomes legally enforceable. This means that they are required by law to fulfill their obligations and to gain the rights identified in the contract.

Now complete the following activity.



Activity

Mr. King, a building contractor, accepted an offer from Ms. James to construct a house according to an approved plan. Ms. James made a down payment of fifty dollars and both parties agreed that the remaining one hundred thousand dollars would be paid on completion of the house, which was expected to be in three months. The house was completed in the stipulated time and built according to the approved plan. Ms. James was satisfied with the job that was done. She paid the one hundred thousand dollars to Mr. King.

Ms. James now lives comfortably in her new house. Based on a positive recommendation that Ms. James then gave to a friend, Mr. King has secured a new contract to construct a house for her friend.

- (a) Explain whether or not a valid contract existed in this scenario.

An honoured contract

When the parties of a valid contract fulfill their obligations and gain the rights that were identified, the contract is said to have been honoured. Parties are no longer under any legal obligation to do anything relating to that contract. For example, in the scenario from the activity above, the contract between Ms. James and Mr. King was honoured when he completed construction of the house and she paid him in full for the job done.



Reflection

What do you think must be done if Ms. James decides that she wants Mr. King to add another room to her house?

You most likely correctly answered that a new contract will have to be formed for that new job.

Once all the terms and conditions stipulated in a contract have been fulfilled or honoured, the contract comes to an end. If both parties want to proceed with another agreement, a new contract must be made.

An invalid or void contract

A contract is declared void or invalid if any of the principles necessary for a valid contract are not present or are violated. This means that no contract exists.



Activity

Review the first section of this session which outlined the principles necessary for the formation of a contract. Explain two examples of situations which can cause a contract to be declared void or invalid.

A counter offer

Consider this example:

Zane offers to sell a pair of Timberland boots for \$2,000 to his friend Vane. Vane said that he would purchase the boots but was only willing to pay \$1,500.

Do you recognise the offer in this example? It is Zane's statement that he will sell a pair of Timberland boots to his friend Vane for \$2,000.

Was there an unconditional acceptance to this offer?

No, because Zane's offer price of \$2,000 for the boots was refused by Vane, who said he was willing to pay only \$1,500. This is an example of a counter offer.

A counter offer occurs when another offer is made in response to an original offer. The counter offer indicates that the original offer is not acceptable but the offeree is willing to continue negotiating under new terms.

In our example, Vane cannot force Zane to sell at the lower price. If Zane agrees with the counter offer, he can make a new offer at that price. Then if Vane accepts this new offer unconditionally, the agreement can become legally binding, once the other principles necessary for a contract are met.

An Invitation to Treat

An invitation to treat is a request made by individuals or businesses for interested parties to make an offer to form a contract. It indicates that the person making the invitation to treat might be willing to entertain an offer but is not obligated to do so. If an offer is accepted, then the formation of a contract will begin between the two parties.

Examples of invitations of treat include:

1. Advertisements

Examples of advertisements that are invitations to treat include forms such as:

- ✓ Goods displayed in showcases or advertised in the media with or without prices.
- ✓ A mail order catalogue advertising items for sale and stating the terms of sale.
- ✓ Sale of property that is advertised in the media or on signage shown outside or on the property to be sold. The signage of the sale may look like the one below.



Figure 2

An invitation to treat, such as an advertisement by a business, does not obligate the person issuing the invitation to sell the item to anyone even if the other party is willing to pay.

2. Auctions

At auctions items are identified or displayed and persons are invited to bid on them by indicating prices they are willing to pay. The auctioneer has the right to determine which offers of bids, if any, he/she is willing to accept. There is no obligation to accept a bid. However, once a bid is accepted, the procedure for the formation of a contract is set in motion.

By now you will have realised that advertisements and auctions are examples of an invitation to treat. These are not offers but are requests for others to make an offer. When an offer is made in response to an invitation, it can be accepted or rejected. If an offer is accepted, then the formation of a contract will begin between the two parties.

An Invitation to Tender

An invitation to tender is a special type of advertisement requesting interested parties to submit proposals to undertake a specified job. The proposal is called a tender and it will contain an estimate of the costs, as well as the terms and conditions. The tenders will be compared in order to make a decision about which one to accept. The details of the contract will then be negotiated between both parties.

Businesses use the tendering process in cases such as:

- ✓ Finding the right suppliers of inputs or stocks: For example, a restaurant wishing to have a daily supply of fresh vegetables can issue a tender for the supply of vegetables. Farmers will then respond with the types, prices and schedules at which they can supply vegetables. The restaurant owner will then decide which one is best suited for the business and negotiate a contract with that farmer.
- ✓ Hiring a building contractor: As an example, if the Ministry of Education wants to build a school, it will invite tenders from contractors to supply details of the cost of constructing the school. The Ministry will then decide which one of the contractors is best suited for the job and negotiate a contract with that contractor.



Discussion

Can you think of other instances when a tender may be used to decide on the best possible person or business to enter into a contract with? You can share your thoughts on this with your classmates/tutor.

Session Summary



Summary

In this unit you learned about the basic principles of contracts.

- A contract is an agreement between two or more parties who are compelled by law to carry out promised actions.
- There are six basic principles necessary for the formation of a contract. These principles are:
 1. Offer: a clear proposal made by one party, called the offeror, to another party, called the offeree.

2. Acceptance: when the offeree agrees to the offer or proposal made by the offeror.
3. Consideration: the price or benefit promised by one party to the other in order to secure mutual performance of the desired actions.
4. Legality of purpose: this assurance that what is being agreed upon by the parties must not violate existing laws of the relevant country.
5. Genuine assent: this exists when the acceptance in an agreement is not clouded by fraud, duress or undue influence.
6. Possibility: it must be reasonably possible for the parties of a contract to be able to do what is being agreed upon.

Some terms which may arise in connection with the law of contracts are:

- A valid contract is one that meets all the principles necessary for the formation of a contract and is thus enforceable by law.
- An invalid or void contract is not legally enforceable when one or more of the principles necessary for the formation of a contract has been violated.
- An honoured contract exists when the parties to a valid contract fulfill their obligations and gain the rights that were identified.
- A counter offer occurs when another offer is made in response to an original offer. The offeror attaches conditions to the acceptance of an offer. A counter offer cannot be the basis for the formation of a contract.
- An invitation to treat is a request made by individuals or businesses for interested parties to make an offer to form a contract. The offer made can be accepted or rejected and the person issuing an invitation to treat is under no obligation to enter a contract.
- An invitation to tender is a request for interested parties to submit proposals to undertake a specified job. After comparing tenders, and deciding on which one to accept, a contract is awarded. Subsequently, a contract will then be negotiated between both parties.

Assessment



Assessment

Answer the following questions using complete sentences. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. Explain what you understand by the following statement:

“A contract is based on an agreement but an agreement is not a contract”. (4 marks)

2. Discuss two guidelines that govern acceptance in a contract. (4 marks)

3. Explain what “consideration” is in the context of a contract. (2 marks)

4. Identify two examples of persons who may not have “capacity” to make contractual arrangements. Justify your choices. (4 marks)

5. Distinguish between the following terms:

- i. Offer and counter offer. (2 marks)
- ii. A valid contract and a void contract. (2 marks)
- iii. An advertisement and an invitation to tender. (2 marks)

Total: 20 marks

Session 2: Simple Contracts and Specialty Contracts

Introduction

You have seen in Session 1 that a contract is a legally binding agreement made between two or more persons who intend to create a legal relationship or obligation to each other.

In this session you will learn about simple contracts and specialty contracts commonly used in business transactions. Simple contracts are made by actions implied, oral agreements or in writing, while specialty contracts must be made in writing.

Upon completion of this session you will be able to:

- *Explain* what a simple contract is.
- *Describe* specialty contracts.
- *Compare* the features of a simple contract and a specialty contract.



Outcomes



Terminology

Simple Contract:	A legally binding agreement that requires no special format.
Specialty Contract:	A legally binding agreement that must be written, witnessed, signed, sealed and delivered.
Seal:	The official mark, impression, symbol or stamp of an organisation.

Characteristics of Simple Contracts

A simple contract is a legally binding agreement that requires no special format. This means that the agreement does not have to be in writing; it can also be oral or implied by conduct.

Oral contracts occur when agreements are made by spoken words.

Written contracts occur when the terms and conditions of the agreement are transcribed clearly.

Contracts that are implied by conduct mean that the actions of the parties involved in the agreement are based on mutual understanding and expectations, even if the terms and conditions are not clearly expressed verbally. All simple contracts must contain at least three principles: offer, acceptance and consideration. You learnt about these in the last session.

The diagram below illustrates the three possible ways in which a simple contract can be made.

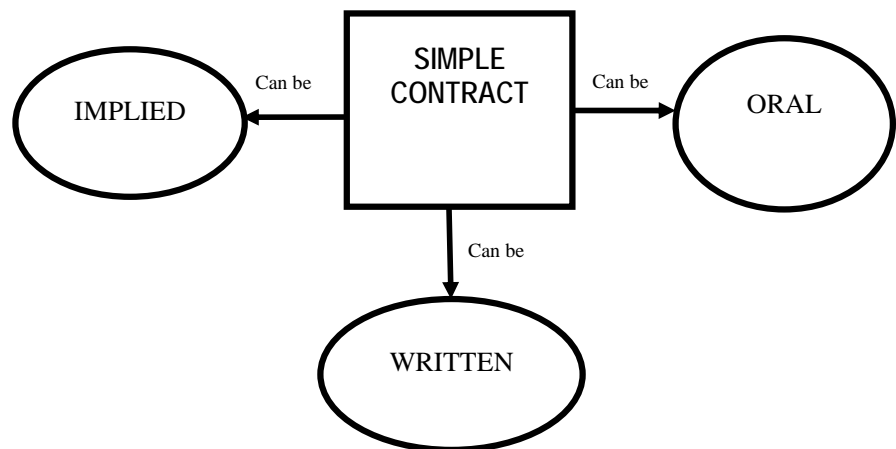


Figure 3

Implied contract

A simple contract can be implied by the actions or conduct of persons involved. As noted earlier, such actions or conduct are implied because they are not verbally expressed. For example, the simple wave of your hand to stop a taxi displays your intention of entering into a contract. The taxi driver is offering the service of transport. By stopping the taxi, you have signaled an acceptance of that offer. It is implied that you will pay the fare and the driver will take you to a particular destination. For the taxi driver, the benefit or consideration received will be the fare and for you, the benefit or consideration received will be transportation to your destination.



Reflection

You will notice that with an implied contract there is no direct exchange of words between the parties. Instead, their actions suggest what is being offered and accepted and if an agreement has been reached. The benefits derived by the parties become the consideration.

Can you think of other examples of an implied contract?

You may have accurately thought of purchasing transactions. For example, customers select items at a store or supermarket, take them to the cashier, make the required payment and legally receive ownership of the items. Here all the basic principles necessary for formation of a contract have been met. No words are actually spoken but a contractual agreement has been formed where legal rights and obligations have been created.

Oral contract

An oral contract is formed when there is an exchange of words between two or more parties, making a verbal agreement with the intention of creating legal rights and obligations.



Activity

Examine the following scenario:

- A carpenter says he/she will build a table for Ms. Jones at a price of \$1,000. Ms. Jones, a school teacher, replies that she will buy the table and she makes a down payment of \$500. The carpenter promises that the table will be delivered in two weeks.

You can identify the principles of a contract evident in this example by answering the following questions:

Was there an offer and acceptance? If so, identify each.

Will both parties receive benefits or consideration?

Do these persons have the capacity to make a contractual arrangement?

Is the action under consideration legal and possible?

From your activity, you will realise that the conversation between the carpenter and Ms. Jones resulted in the formation of an oral contract. The carpenter is legally obligated to deliver the table and receive the money. Ms. Jones will have a legal right to the table when she pays for it as the basic principles necessary for a valid contract were met. You can now review these:

The carpenter made an offer to build a table, which Ms. Jones accepted.

Consideration will be the money paid to the carpenter and the table Ms. Jones will get.

Both persons meet the criteria for capacity as it can be assumed they are sane, sober adults.

The transaction is legal with the possibility of being performed.



Discussion

In the business world, many spoken exchanges among persons are in fact oral contracts once all the basic principles for the formation of a contract are met. Identify some examples of oral contracts and discuss them with your classmates.

Written contract

A simple contract can also be in writing. This means that the task to be done will be shown in written form and one or both parties will sign in agreement.

Using the previous example between Ms. Jones and the carpenter, a written contract will exist if the transaction is expressed in writing. The document may include the date of the transaction, the parties involved, description of the table to be made, the agreed price, down payment and balance due, and the date of delivery of the table. Both parties will sign the document to indicate they have agreed to the terms and conditions outlined.

In the business environment, transactions involving sale of goods and services is the most common example of simple contracts. Usually when something is sold, some form of written evidence is provided by the seller to the buyer as proof of purchase. You may be quite familiar with the most common proof of purchase: the simple receipt that is generated from the cash register.

So far you have seen in this session that business transactions, especially those involving sale of goods and services, can be implied, oral or written.



Discussion

What do you think are the advantages a written contract will have over oral and implied contracts? Discuss this with your classmates/tutor.

You will now look at specialty contracts, which are contracts that must be in written form.

Specialty Contracts



Reflection

Suppose you purchased a piece of land and received no document to show that you now own the land. Would you be able to sell the land if you have no proof of ownership?

Your answer will most likely be no. Do you know why?

It is because this type of transaction requires a specialty contract.

Now you are wondering what a specialty contract is.

A specialty contract is a contract of deed. This means it must be written, signed, sealed, witnessed and delivered. These terms will soon be explained. Additionally, in a specialty contract, the basic principles

necessary for the formation of a contract must be present. You learnt about these earlier on in session 1 of this unit.

Consider the following questions and answers to gain a better understanding of the characteristics of a specialty contract:

Why is a specialty contract in writing?

This is necessary because a written or printed document will serve as physical proof of a transaction.

Who signs a specialty contract?

It is signed by the parties involved to indicate that they have personally agreed with the terms and conditions of the contract.

What does it mean when a specialty contract is sealed?

To be sealed means that an organisation's official mark, impression, symbol or stamp is affixed to the document in order to validate the contract and to certify the signatures, that is, to verify their accuracy.

How is a specialty contract witnessed?

A specialty contract is witnessed when a third person sees the signatures of both parties being affixed to the contract. The witness must also affix his/her signature to verify the validity of the signatures of both parties.

How is a specialty contract delivered?

A specialty contract is delivered when copies of the written contract are handed to both parties. These copies serve as tangible or physical proof of the contractual transaction.

You will now examine examples of the use of specialty contracts in the business environment.

Examples of specialty contracts used in the business environment

Some examples of specialty contracts used in the business environment include but are not limited to contracts of employment, contractor agreements, hire purchase agreements, lease contracts, mortgage deeds, transfer of land, licensing agreements, insurance policies and loan agreements. You will now take a brief look at what information some of these contracts contain.

- **Contract of employment:** This is a document that contains an agreement between an employer and an employee. It usually outlines the terms and conditions of employment, such as salary, dates of

payment, duration of employment, circumstances for termination, and a general job description.



Discussion

If you are being hired for a job, what do you think will be the advantages of having a contract of employment with your employer? Discuss this with your classmates/tutor.

- **Contractor agreements:** Sometimes a business may hire an independent person(s) or an organisation to perform a specific job. Since these persons are not de facto employees, an agreement will be made between the two parties outlining their duties, responsibilities and obligations for the job to be performed.

Some examples of contractor agreements include:

- ✓ An agricultural farmer may hire a transport company to deliver fruits and vegetables to supermarkets on specific dates and times.
- ✓ A building contractor may be given a contract to construct a new building.
- ✓ A business may have a contract with a cleaning company to clean its premises at specified times, instead of hiring permanent staff to perform this job.

You can think of other examples of contractor agreements commonly used by businesses.

- **Hire purchase agreements:** Have you or anyone you know, ever bought something on a “Buy Now Pay Later” plan?

Being able to use or obtain products and then pay for them later is essentially what hire purchase is. Many businesses offer to sell relatively large and expensive items, like electronics and household appliances, on hire purchase. The buyer makes a down payment and agrees to pay the remaining money over a period of time but he/she gets immediate use of the item(s) bought on hire purchase.

A specialty contract is used in hire purchase transactions with the terms and conditions governing both parties clearly outlined.

- **Lease contracts:** These are usually used when persons are renting property like buildings, land, vehicles or machinery for a period of time. It is drawn up between the owner and the person renting the item.

What information do you think a lease will contain?

Following the trend of the previous examples, you most likely would have correctly identified information such as:

- ✓ Who the parties are
 - ✓ Description of the item to be rented
 - ✓ Cost and duration of rental
 - ✓ Special conditions governing use of the item
 - ✓ Any exceptional circumstances that can bring the lease contract to a premature end
 - ✓ Signatures of the parties involved
- **Licensing agreements:** You will recall that in Unit 2 you learnt about regulations governing businesses such registration, licences, patents and copyrights to name a few. The details of these are formalised in specialty contracts that clearly identify the terms and conditions that are agreed upon, as well as legal rights and obligations.
 - **Loan agreements:** In Unit 16 you will learn more about loans, but following the trend of the previous examples of specialty contracts, complete the following activity.



Activity

Imagine that you are in charge of a bank that grants loans. What kind of information would you want a loan contract to state? Make a list of the information that will be on your loan contract.

A loan agreement should contain the following information:

- ✓ Name of the bank (the lender) and the borrower
- ✓ The amount of money being lent
- ✓ The interest charged on the loan and any other fees the borrower has to pay
- ✓ Details of how the loan will be repaid, e.g. how much per month and for how long

- ✓ Steps that will be taken if the borrower defaults in repayment of the loan
- ✓ Signatures of the lender and borrower



Group activity

The following activity has been designed for you to complete with your colleagues.

Complete the table below with examples of simple contracts and specialty contracts that are commonly used in the business environment

Examples of Simple Contracts	Examples of Specialty Contracts

Figure 4

You may have come up with some of these points:

SIMPLE CONTRACTS	SPECIALITY CONTRACTS
Implied: Travelling on a bus; taking goods to the cashier at a store	A loan agreement between a bank and a borrower
Oral: Ordering food at a restaurant	A life insurance policy
Written: Purchasing household items and clothing where an invoice or printed bill is given	An employment agreement between an employer and an employee
	Licences
	An agreement between a building contractor and a person(s) for construction of a building

Figure 5

In this session you learnt about the features of a simple contract and a specialty contract. An assessment has been prepared for you to do as a review. When you have completed that task, you will then be introduced to the next session to learn about the termination of contracts.

Session Summary



Summary

In this unit you learnt about the features of simple contracts and specialty contracts.

You learnt the following:

- A simple contract is a legally binding agreement that requires no special format.
- A simple contract can be implied, oral or written.
- A specialty contract is a contract of deed. This means it must be:
 - written
 - witnessed
 - signed by both parties
 - sealed
 - delivered

Assessment



Assessment

Please answer the following questions using complete sentences. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. Distinguish between the following:
 - a) An implied contract and an oral contract (2 marks)
 - b) A simple contract and a specialty contract (2 marks)

2. Explain what it means for a contract to be:
 - a) Sealed (2 marks)
 - b) Witnessed (2 marks)

3. Identify four conditions that a contract of employment should contain. Justify the importance of each of the condition you identified. (8 marks)

Total: 16 marks

Session 3: Termination of Contracts

Introduction

What do you think happens when parties to a contract have done what they agreed to do? Will they still be obligated to each other? Of course not, because the completion of obligations brings a contract to an end. At times however, circumstances may make it impossible for parties to fulfill their obligations or there may be other occurrences that force a contract to be legally ended. As you study this session you will learn about the different ways in which a contract may be terminated.

You will also be given the opportunity to apply your knowledge of contracts in the business environment as you examine and discuss a few simple case studies.

Upon completion of this session you will be able to:



Outcomes

State the meaning of termination of a contract.

Explain ways in which a contract can be terminated.

Define breach of contract.

Recommend solutions for dealing with breach of contract.

Apply the principles of a contract to simulated scenarios.



Terminology

Termination or discharge of a contract:

When obligations required by both parties in a legally binding agreement are ended.

What is Termination of a Contract?

Look at the picture below and describe what you see.



Figure 6

Source: Distance Education Unit /Multimedia Department

In the picture above, someone is tearing up a contract. In reality a contract may not be literally torn up but the picture is being used to introduce the concept of termination of contracts.

What is the meaning of termination?

Termination means to bring to an end.

A contract is considered to be terminated when the parties involved are no longer under legal obligation to perform what was agreed upon. Another term used to describe the termination of a contract is discharge.

How Can A Contract Be Terminated?

A contract is *terminated* or *discharged* when the obligations required by both parties have come to an end. Termination may occur when both parties complete what they agreed to do or agree to terminate the contract before contract completion. You will now examine methods of termination of a contract.

Methods of termination of a contract

1. Performance

A contract is terminated by performance when both parties to the contract fulfill or honour their obligations and get what they agreed upon. The parties are no longer under any legal obligation to do anything further for each other.

For example, a shipping company was contracted to make a special delivery of cargo from China to Jamaica for ABC Ltd. This was done in the stipulated time and the shipping company received the predetermined payment from ABC Ltd. This contract has been terminated or discharged by performance.

**Reflection**

What do you think must happen if ABC Ltd. wants the shipping company to do another delivery in the future?

Most likely you correctly answered that the parties will have to make a new contract.

What should be done if ABC Ltd. requires the shipping company to make regular deliveries of cargo?

A new contract must be made, outlining the specific times that deliveries are required and other terms and conditions that are relevant to the agreement.

2. Impossibility of Performance

After a contract is made, if some event or circumstance beyond the control of one or both parties occurs to make it impossible to perform what was agreed upon, then the contract can be legally terminated.

Examine the following examples which illustrate impossibility of performance in contracts:

- An entertainment promoter hires a popular singer to perform at a concert and the singer dies. The contract is terminated by impossibility because the deceased singer cannot perform. Usually contracts that involve use of personal skills or services are terminated by the death of the person.
- Company A made a contractual agreement to purchase a building from Mr. Smith. The building is destroyed by fire before the sale is completed. It is impossible for Mr. Smith to legally honour his obligation because the building no longer exists. The contract will thus be terminated.

You may be wondering what will happen if down payments were made in these transactions. It is advisable that persons get legal advice when drafting contracts to ensure that a clause is included to provide some form of compensation for losses suffered, if situations arise that can cause impossibility of performance. If this is not done, parties will have to bear their losses.

**Reflection**

Try to think of other examples of situations when it may become impossible to do what was agreed upon in a contract.

3. Mutual consent or agreement

Legally, a contract can be terminated if both parties agree to do so. Mutual agreement or consent exists when both parties who agreed to enter a contract make another agreement to end it.

In real life one of the most common examples of termination by mutual consent is divorce, which is used to legally end a marriage contract. In the business environment, mutual agreement for termination of a contract can occur in the following ways:

- **Novation:** This occurs when all parties agree to either replace an existing obligation with a new obligation or to replace one party with another party.

For example, assume that Farmer A has a contract to supply vegetables to Company X and Company X has a contract to supply vegetables to Restaurant Y. If all parties agree, the two contracts can be novated or terminated and replaced with a single contract where Farmer A supplies vegetables directly to Restaurant Y.

- **Alteration:** This occurs when both parties remain the same but they agree to change the terms of the contract.

For example, if Company A had a contract to supply lunches to a school, and the school also requires breakfasts, the contract can then be altered to include this additional obligation.

- **Merger:** this occurs when an inferior right of one party is combined with a superior right under the same contract.

For example, Company A has certain rights in a contract for a lease to rent a building. If Company A buys the building, its rights as a renter will be merged with its rights as the owner.

- **Occurrence of event(s) previously agreed upon:** if a contract has specified conditions or events that can cause the contract to come to an end and they occur, the contract will then be terminated.

For example, if an employment contract states that an employee will be fired for stealing, and the employee is then caught stealing, the contract of employment will come to an end.

4. Breach of contract

Breach of contract arises when one party fails to perform what he/she was legally obligated to do. Once a breach occurs, a contract is legally terminated.

A breach occurs if one party:

- Refuses to meet his/her obligation.
- Does something that should not be done.
- Prevents the other party from doing what was supposed to be done.

A breach of contract can be immaterial or material.

An immaterial breach is also called a minor breach and is one that does not really matter. For example, assume a newspaper company has a contractual agreement to deliver newspapers to a news stand at 7 a.m., but instead delivers at 7:05 a.m. This breach does not significantly affect the terms and conditions of the contract since the newspapers were actually delivered.

Conversely, a material breach matters as it directly affects the terms and conditions of the contract. Using the above example, there would be a material breach if the newspaper company does not deliver any newspapers at all.

The party that suffers or incurs losses from the breach of a contract can take legal action or sue the party that caused the breach. The court will review the case and decisions made may include:

- Awarding compensation: The party that breached the contract may be ordered to pay the other party the cost of losses or damages incurred.
- Compelling the party that breached the contract to perform the obligation that was initially agreed upon and/or to pay compensation for losses or damages incurred.

5. Bankruptcy/Insolvency

Insolvency arises when a business is unable to earn enough money to meet its daily expenses and to pay its debts. The term is often used interchangeably with bankruptcy, even though technically bankruptcy applies to individuals, not businesses.

If a business finds itself in the unfortunate situation of legally declaring bankruptcy, it is usually closed down and released from honouring contracts. This legally terminates contracts the business may have had. However, persons/business which had contracts with the now insolvent

business will have to sue for damages and await the decision of the court for compensation.

In many contracts made by businesses, a clause is usually included to state that the contract will terminate in the event of legally declared bankruptcy/insolvency. In this way, the business is legally freed from honouring obligations if this situation arises.

6. Death

As previously stated, when a contract requires services of a personal nature to be performed, the death of the person contracted to do so will terminate the contract. However, in other cases where contracts are for material things, the rights, obligations and liabilities will be passed on to the legal representative of the party that has died.

For example, if a person entered a contract to purchase a new vehicle for his business, paid the money and then subsequently died, his legal representatives would be entitled to receive the vehicles. When all obligations are fulfilled by both parties, the contract would then be terminated.

7. Lapse of time

Some contracts may stipulate a time period within which the parties must perform their obligations. If this time period passes, the contract is legally terminated due to lapse of time. Usually a condition may be included where any monetary consideration received will be forfeited.

For example, assume a manufacturer allows a business to make a down payment of ten percent and gives ninety days for the balance to be paid before the goods ordered can be delivered. If the ninety days pass and payment is not made, the contract will legally come to an end.

The specific terms and conditions outlined in the contract will determine what happens next. If there was a forfeiture clause, the down payment can be forfeited or kept by the manufacturer; if there was a return of cash clause, the business will be able to recover the down payment made.

8. Fraud, Misrepresentation and Mistakes

In Session 1 of this unit you learnt about the principle of “genuine assent” and “capacity of parties”. Can you recall these principles? Take the time review these terms.



Reflection

Suppose a fifteen year old child accepts five hundred dollars as a down payment and signs an agreement to sell his/or her father’s car to an adult. Do you think a court of law will uphold this contract? If not, why?

Most likely you correctly answered that the court will not uphold this contract. Instead, it will be terminated and declared to be void because

one of the basic principles necessary for the formation of a contract was violated. A fifteen year old is a minor and does not have capacity to legally sell a car. Additionally, there was misrepresentation because the child does not own the car so he/she is not legally able to negotiate a sale for it.

Misrepresentation can be fraudulent or innocent. Fraudulent misrepresentation occurs when one knowingly gives false statements. Innocent misrepresentation occurs when an untrue statement is made by someone who believes that the statement is true. Both types of misrepresentation are grounds for declaring a contract void and legally ending it.

A contract may be terminated if it was made under force or duress. For example, if someone holds a gun to a person's head to force him/her to sign a contract, it can be terminated once the force or duress can be proven.

Sometimes mistakes may be made when making an agreement and the contract may be finalised with that error. A mutual mistake may occur if both parties agree to the subject of the contract but they are mistaken about a particular aspect of the contract.

For example, Mark has two cars to sell and John is paying for one. Mark is planning to sell the red car and John believes he is buying the blue car. After the transaction is completed and the mistake is realised, the contract can be legally terminated. Neither party was deliberately misleading each other nor was there fraudulent misrepresentation; there was a genuine or innocent misunderstanding regarding the subject matter of the contract. If desired, the parties can, in good faith, begin negotiations for a new contract.



Activity

You will now apply what you learnt in this session to a few very simple case studies/scenarios.

❖ Scenario 1

After comparing prices at several different stores, Ms. Jones bought a washing machine at ABC Ltd. under a hire purchase agreement. She was so pleased with the price that she willingly signed an agreement that excluded all guarantees on the item. After two weeks the washing machine stopped working. She decided to sue ABC Ltd. to get a new washing machine or a full refund of her money.

- 1) What type of contract does a hire purchase agreement represent? Give reasons to support your answer.

- 2) Advise Ms. Jones on whether or not she will succeed in court in her case against ABC Ltd.

❖ Scenario 2

As a twenty year old student who graduated from a prestigious institution, you sent out applications and were hired by an established equipment manufacturing company as a sales representative.

As a new sales representative in the manufacturing company, you take your first customer out to dinner. Before the dinner is over, you have shaken hands on a deal to sell the customer nearly two million dollars of equipment. In writing up the formal contract the next morning, you discover that you misquoted the price of the equipment. Your error will cost your company an average of \$60,000 on each of the equipment. You telephone your customer and explain the situation.

- 1) In the above scenario, did you make a valid contract?
- 2) Will the mistake allow you to end the contract?
- 3) What do you think should happen in this situation?

You may have noticed that this scenario illustrates legal issues such as:

- At what point does the “deal” become a contract?
- Whether the verbal deal must be in writing so that it will become legally enforceable.
- Whether you have the legal authority to make a contract on behalf of your company.
- If misquoting the price of the equipment excuses your company from having to sell it at that price.
- If the company tries to get out of the deal, it risks losing the customer’s business in the future.

❖ Scenario 3

Kate, who is studying in England, sent letters to several friends in Jamaica, which included a flyer advertising the car she had left at home for sale at a price of twenty thousand dollars. Alison, one of her friends, posted a letter accepting the offer and included a cheque for the twenty thousand dollars.

Alison went to Kate's house and demanded possession of the car. Kate's mother refused to hand over the car because Kate had subsequently informed her that she was no longer interested in selling the car. Allison decided to sue Kate for the car.

- 1) Do you think Allison will be successful in her case against Kate?
- 2) Imagine that you were defending Kate in a court of law, what points would you present in your case?

❖ Scenario 4

On March 4th, John made a down payment of five thousand dollars on a 2005 Honda motor car to Mr. Ali at a used car dealership. The price of the car was forty-five thousand dollars. John agreed to pay the remaining forty thousand dollars in seven days time and Mr. Ali said he would keep the car for him.

On March 6th Mary offered to pay Mr. Ali fifty thousand dollars cash for the same 2005 Honda motor car and he sold it to her. When John took the forty thousand dollars to Mr. Ali he realised that the car had been sold.

- (1) Was there a valid contract between John and Mr. Ali?
- (2) If a contract existed, did Mr. Ali breach it?
- (3) Advise John on what legal action he can take.

Session Summary



Summary

The table below gives a brief summary of the different ways in which a contract may be terminated.

Some ways in which a contract can be terminated

Termination Factors	Description
Performance	Both parties fulfilled or honoured their obligations and got what they had agreed upon.
Impossibility of performance	Some event or circumstance beyond the control of one or both parties occurred to make it impossible to perform what was agreed upon, such as death or destruction of the subject matter.
Mutual agreement or consent	Both parties who agreed to enter a contract made an agreement to end it.
Breach of contract	One party failed to perform what he/she was legally obligated to do. Legal action can be taken against the person who breached the contract.
Insolvency/bankruptcy	If a business legally declared bankruptcy, it is usually closed down and released from honouring contracts.
Death	If the party contracted to render a personal service dies.
Lapse of time	If either party is unable to deliver what is promised by the stipulated date.
Fraud, misrepresentation and mistakes	Any evidence of improper actions on the part of one or both parties, or violation of any of the basic principles necessary for the formation of a contract.

Figure 7

Assessment

Answer all of the questions below. Once you have completed this assessment, use the answers provided in the Learners Guide to mark your work. If these have not been provided to you, submit the assessment to your tutor for evaluation.

1. Why does “performance” cause a contract to be terminated? (1 mark)

2. Explain two ways in which “breach of contract” can occur. (2 marks)

3. What are two remedies for breach of contract that can be awarded by a court? (2 marks)

4. Give an example of how a contract can be terminated due to “impossibility of performance”. (1 mark)

5. Explain the meaning of the following terms in the context of a contract:
 - (a) Lapse of time (2 marks)

 - (b) Fraudulent misrepresentation (2 marks)

Total: 10 marks

Unit Summary



Summary

In this unit you learnt the following about contracts in the business environment:

- A contract is an agreement between two or more parties who are compelled by law to carry out promised actions.
- The six basic principles necessary for the formation of a contract are:
 1. Offer
 2. Acceptance
 3. Consideration
 4. Legality of purpose
 5. Genuine assent
 6. Possibility
- A valid contract meets all the principles necessary for the formation of a contract and is enforceable by law, while a void contract is not legally enforceable as one or more of the principles has been violated.
- A counter offer occurs when another offer is made in response to an original offer.
- An invitation to treat is a request made by persons or businesses for interested parties to make an offer to form a contract.
- A simple contract is a legally binding agreement that requires no special format. It may be implied, oral or written.
- A specialty contract is a contract of deed and it must be written, witnessed, signed by both parties, sealed and delivered.
- Ways in which a contract can be terminated include:
 - Performance
 - Impossibility of performance
 - Mutual agreement or consent

- Breach of contract
 - Insolvency/bankruptcy
 - Death
 - Lapse of time
 - Fraud, misrepresentation and mistakes
- When there is breach of a contract, the injured party can take legal action and the court will make a decision on whether or not compensation should be awarded.

Assignment



Assignment

This assignment consists of 15 multiple choice questions. Circle the best answer to the statements given. You should spend approximately 15 minutes completing this assignment.

- (1) A contract may be defined as a
- (a) Memorandum of Association.
 - (b) Articles of Association.
 - (c) Legally binding agreement.
 - (d) Tender.
- (2) An _____ is the party to whom the offer is made
- (a) offeror
 - (b) offeree
 - (c) acceptor
 - (d) drawer

- (3) Which of the following describes an invitation to treat?
- (a) Stopping a taxi
 - (b) An advertisement for sale of used cars
 - (c) Purchasing of selected items
 - (d) An acceptance of an offer
- (4) Specialty contracts are
- i. Implied and written
 - ii. Signed and sealed
 - iii. Written and witnessed
 - iv. Written and verbal
- (a) (i) and (ii) only
 - (b) (i) and (iii) only
 - (c) (ii) and (iii) only
 - (d) (iii) and (iv) only
- (5) When a person provides labour services in return for wages the document setting out the terms and conditions is called a
- (a) contract of record.
 - (b) deed.
 - (c) contract of employment.
 - (d) insurance policy

(6) Which of the following principles must a simple contract have?

- i. Acceptance
- ii. Deed
- iii. Consideration
- iv. Offer

- (a) (i) and (ii) only
- (b) (i) and (iv) only
- (c) (i), (ii) and (iv)
- (d) (i), (iii) and (iv)

(7) Which of the following items below prevents an agreement from being considered as a valid contract?

- (a) Offer and acceptance
- (b) Capacity of parties
- (c) Misrepresentation
- (d) Consideration

(8) Kandy Kane was offering her SUV van for sale at \$20,000. Her friend, Suzie Nutt, stated that she wanted the SUV van and would pay \$15,000. This scenario describes a(n)

- (a) contract
- (b) counter offer
- (c) statement of intention
- (d) agreement

(9) Which of the following BEST describes the definition for a bid?

- (a) The price at which a business or individual is prepared to buy
- (b) A clear proposal made by one party to another party for acceptance
- (c) An agreement that occurs between two parties or more for a property
- (d) An agreement between two parties or more for an action to be performed

(10) Which of the following principles are present when a contract is being formed?

- i. Offer and acceptance
- ii. Consideration and possibility
- iii. Counter offer and past consideration
- iv. Legality of purpose and genuine assent

(a) (i), (ii) and (iii)

(b) (i), (ii) and (iv)

(c) (i), (iii) and (iv)

(d) (ii), (iii) and (iv)

(11) Simple contracts may consist of the following characteristics

(I) Implied

(II) Oral

(III) Writing

(IV) Witnessed

(a) I, II and III

(b) I, II and IV

(c) I, III and IV

(d) II, III and IV

(12) Some examples of specialty contracts are

(I) Bill of sale of materials

(II) Lease contracts

(III) Mortgage deeds

(IV) Insurance policies

(a) I, II and III

(b) I, II and IV

(c) I, III and IV

(d) II, III and IV

(13) A contract may be discharged by

(I) Mutual consent

(II) Performance

(III) Breach

(IV) Offer and acceptance

(a) I and II

(b) III and IV

(c) I, II and III

(d) II, III and IV

(14) A seal is an official mark affixed to a(n)

(a) Specialty contract

(b) Implied contract

(c) Oral contract

(d) Simple contract

(15) A document drawn up between two parties for rental purpose is called a

(a) Contract of employment

(b) Hire purchase agreement

(c) Lease contract

(d) Contract agreement

Total: 15 Marks