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Peter Stimpson and Kathleen Singh
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CAPE introduction

This book has been specifically written for students following the CAPE Management of Business course, Unit 1. It has a companion volume that covers Unit 2 of this syllabus.

This volume follows the Unit 1 part of the syllabus very closely and it therefore provides all of the material and support needed by all students.

The key and distinctive feature of both books is the emphasis on Trinidad and Tobago and Caribbean issues. These are reflected in not only the content of each chapter – with frequent and appropriate references to regional details or examples – but also in many of the case studies and activities that occur within each chapter and in the 'Over-to-you' section at the end of each chapter. These constant reminders of the business environment in the Caribbean in general, and in Trinidad and Tobago in particular, enable students to put the syllabus material into a familiar context.

Using the book

It is unlikely that even the keenest student will read this text from cover to cover in one evening! Instead, it should be used to support and guide learning as a student progresses through the syllabus. The study of each syllabus topic will be helped by the following features of each chapter:

- Every chapter begins with a list of targets that give a sense of direction to the material being covered.
- A clear reference is given at the start of each chapter to the syllabus module and section referred to in the chapter.
- Each topic is explained carefully, often using revision tables of summary 'advantages and disadvantages', to aid memory.
- At important stages in every chapter there are activities, often based on real-world case studies, that invite students to test their understanding of the topics just covered. These activities contain questions that test different 'skills'. These skills reflect the assessment objectives of the CAPE examiners: knowledge, application, analysis and judgement (or evaluation).
- The Over-to-you section at the end of each chapter contains many short revision questions to test students' understanding of the topics explained in the chapter. There are further activities and case study exercises and some essay questions that require detailed and structured answers.
- Towards the end of the book there is a detailed glossary of all important syllabus terms for ease of reference.
- There is a whole section devoted to multiple choice questions with at least five questions related to each chapter.
- Finally, the answers to the multiple choice questions are given together with some suggested answers to selected case study questions. These questions with suggested answers have been flagged up with a * throughout the book.

Skills needed by students of Management of Business

Your final CAPE examinations will test the following skills:

1 Knowledge and critical understanding of the syllabus content.
2 Application of this knowledge and critical understanding of problems and issues that arise from both familiar and unfamiliar business situations.
3 Analysis of problems, issues and situations. This skill can be demonstrated by:
   - distinguishing between statements of fact and opinion,
   - using Business Studies theories to explain an answer,
   - explaining trends in data and the likely causes of them,
   - examining the implications of a suggested idea or strategy.

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4 Evaluation and judgement. This skill can be demonstrated by:
   - weighing up the reliability of data,
   - discussing issues and arguing points in order to reach an appropriate conclusion,
   - discriminating between alternative explanations,
   - judging the usefulness of the main concepts and models of Business Studies.

All of these skills will be developed as you progress through this book, especially if you work through the many questions that are presented for your self-assessment.

Finally, the author hopes that the book, as well as providing essential subject support for CAPE students, will achieve two further objectives. Firstly, it will encourage students to be observant and curious about all forms of business activity. Secondly, as a consequence, they will be keen to discover what is happening in business organisations at both national and local levels and to bring these findings to their studies. You are strongly advised to support and update your knowledge through frequent references to business newspapers and magazines, business-oriented TV programmes and business internet sites.

Good luck with your examinations!

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Unit 1

Management principles and processes

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1 Types of business activity

This chapter covers Unit 1, Module 1, Sections 1 and 2 of the CAPE syllabus. On completion of this chapter you should be able to:

- ➤ understand the nature of economic activity and the problem of choice
- ➤ classify industries into levels of economic activity – primary, secondary and tertiary
- ➤ understand the differences between the private and public sector in your own country
- ➤ identify the different forms of legal organisation of business and evaluate the most appropriate one for different businesses
- ➤ evaluate the arguments for and against privatisation of state-owned industries

Introduction

Many business managers are paid high salaries to take risks and make decisions that will influence the future success of their business. Much of this book is concerned with how these decisions are made, the information needed to make them and the techniques that can assist managers in this important task. However, no student of Business Studies can hope to make much progress in the study of this subject unless they have a good understanding of the economic environment in which a business operates. Business activity does not take place in isolation from what is going on around it. The very structure and health of the economy will have a great impact on how successful business activity is. The central purpose of this whole Unit 'Business and the environment' is to introduce the inter-relationships between businesses, the world in which they operate and the limits that this world imposes on business activity. This first chapter explains the reasons for and nature of business activity and the types of business units that exist in a modern economy.

Economic activity and the problem of choice

We live in a world of great wealth *and* great scarcity. Very poor people are unable to obtain the very basic requirements of life – food, clean water, shelter – and they have great and unsatisfied wants. Even very rich people may not be able to satisfy all of their wants for luxury goods and services. It should be clear to us all that there are insufficient goods to satisfy all of our needs and wants at any one time. It is the purpose of economic activity to provide for as many of our wants as possible, yet we are still left wanting more. This 'shortage' of products and the resources needed to make them lead to us all having to make choices. As we cannot satisfy all of our wants then we must choose which we will satisfy now and which we will forgo. If we are careful and rational we will choose those things that give us the greatest benefit, leaving out those things of less value to us. This need to choose is not exclusive to people as consumers. All economic units have to make choices – governments, businesses, workers, charities and so on.

Opportunity cost

This need to choose leads to the first important principle of our subject – opportunity cost.

In deciding to purchase or obtain one item we must give up other goods as they cannot all be purchased. The benefit that we are giving up from not having the next most desirable item is called 'opportunity cost'. It is the opportunity lost from not obtaining this item instead of the one we chose.

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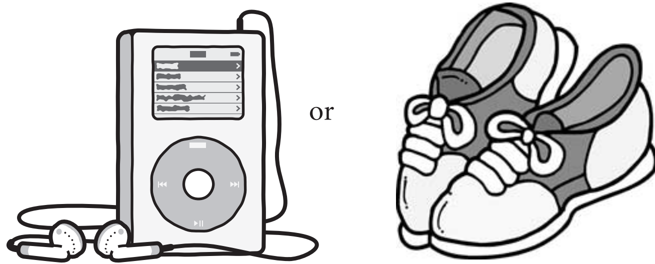
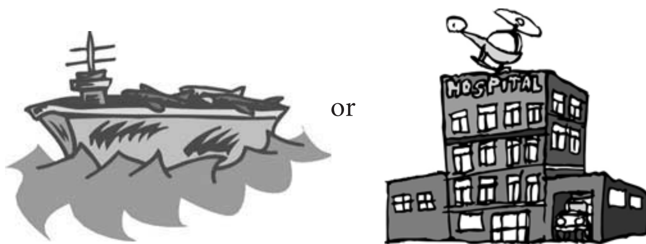


With limited resources if consumers choose to buy the i-pod then the trainers become the opportunity cost.



With limited resources if government chooses to build the warship then the hospital becomes the opportunity cost.

What is business activity?

Businesses identify the needs of consumers or other firms. They then purchase resources – or factors of production – in order to produce goods and services that satisfy these needs, usually with the aim of making a profit. Before we go on it will be useful to explain some important business terms that have either already been used, or will be referred to soon, in this chapter.

Factors of production These are the resources needed by business. They are:

- *Land* – this general term not only includes land itself but all of the renewable and non-renewable resources of nature, such as coal, crude oil and timber.
- *Labour* – manual and skilled labour make up the workforce of the business.
- *Capital* – this is not just the finance needed to set up a business and pay for its continuing operations, but also all of the man-made resources used in production. This includes computers, machines, factories, offices and vehicles.
- *Enterprise* – this is the driving force, provided by risk-taking individuals, that combines the other factors of production into a unit that is capable of producing goods and services. It provides a managing, decision making and co-ordinating role.

Consumer goods These are physical and tangible goods sold to the general public. They include cars and washing machines, which are referred to as durable consumer goods. Non-durable consumer goods include food, drinks and sweets that can only be used once.

Consumer services These are non-tangible products that are sold to the general public and include hotel accommodation, insurance services and train journeys.

Capital goods These are physical goods that are used by industry to aid in the production of other goods and services, such as machines and commercial vehicles.

Classification of business activity

Firms produce a vast range of different goods and services, but it is possible to classify these into three broad types of business activity. These broad categories are also the three stages involved in turning natural resources, such as oil and timber, into the finished goods and services demanded by consumers. The stages are:

Primary sector business activity Those firms engaged in farming, fishing, oil extraction and all other industries that extract natural resources so that they can be used and processed by other firms.

Secondary sector business activity Those firms that manufacture and process products from natural resources, including computers, brewing, baking, clothes making and construction.

Tertiary sector business activity Those firms that provide services to consumers and other businesses, such as retailing, transport, insurance, banking, hotels and tourism.

Changes in business activity It is very important to recognise two features of this classification of business activity:

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1 The importance of each sector in an economy changes over time. *Industrialisation* is the term used to describe the growing importance of the secondary sector manufacturing industries in developing countries. The relative importance of each sector is measured in terms either of employment levels or output levels as a proportion of the whole economy. In many countries of Africa and Asia, the relative importance of secondary sector activity is increasing. This brings many benefits as well as problems:

Benefits:

- Total national output (Gross Domestic Product) increases and this raises average standards of living.
- Increasing output of goods can result in lower imports and higher exports of such products.
- Expanding manufacturing businesses will result in more jobs being created.

Primary production – tobacco growing in Cuba
Source: Still Pictures.

Secondary production – shoe factory in the Dominican Republic
Source: Still Pictures.

Tertiary sector – Le Sport Hotel in St Lucia
Source: Still Pictures.

- Expanding and profitable firms will pay more tax to the government.
- Value is added to the countries' output of raw materials rather than just exporting these as basic, unprocessed products.

Problems:

- The chance of work in manufacturing can encourage a huge movement of people from the country to the towns, which leads to housing and social problems.
- Imports of raw materials and components are often needed, which can increase the country's import costs.
- Much of the growth of manufacturing industry is due to the expansion of multinational companies. The consequences of these are covered later in this chapter.

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In more developed economies, the situation is reversed. There is a general decline in the importance of secondary sector activity and an increase in the tertiary sector. This process is termed de-industrialisation. In the UK the proportion of total output accounted for by secondary industry has fallen by 15% to 23% in 25 years. The reasons for this include:

- Rising incomes associated with higher living standards have led consumers to spend much of their extra income on services rather than more goods. There has been substantial growth in tourism, hotels and restaurant services, financial services and so on – yet spending on physical goods is rising more slowly.
- As the rest of the world industrialises, so manufacturing businesses in the developed countries face much more competition and these rivals tend to be more efficient and use cheaper labour. Therefore, rising imports of goods are taking markets away from the domestic secondary sector firms.

2 The importance of each sector varies significantly between different economies.

Table 1.1 gives details of the differences that exist between different countries' economies and the share of total employment accounted for by each sector of industry.

Private and public sectors

Industry may also be classified in other ways, for example by public or private sector and by type of legal organisation. As we shall see, these two types of classification are inter-linked as some types of legal structure are only found in the private sector.

What is the private sector of the economy?
The private sector comprises businesses owned and controlled by individuals or groups of individuals. In nearly every country, most business activity is in the private sector. The types and sizes of businesses in the private sector can vary considerably. In developing economies the private sector is small. This is because of the lack of entrepreneurial skill and the low levels of savings that are characteristic of this sector. The legal organisation of firms in the private sector is covered below.

What is the public sector of the economy?
The public sector comprises organisations accountable to and controlled by central or local government (the state). In most countries, certain important goods and services are provided by these state-run organisations as it is argued that they are too significant to be left to private businesses. These usually include health and education services, defence, public law and order (police force). In some countries, important 'strategic' industries are also state owned and controlled, such as energy, telecommunications and public transport. In recent years, there has been a trend towards selling these off to the private sector – privatisation – and the impact of this policy is analysed after the section on private sector organisations. In the Caribbean the public sector is the larger sector. This sector employs more people than the private sector.

The legal structure of business organisations – the private sector (see Figure 1.1)
Sole traders This is the most common form of business organisation. One person provides the permanent finance

Country	Primary	Secondary	Tertiary
United Kingdom	2	22	76
Zimbabwe	36	30	34
Trinidad and Tobago	9	26	65

Table 1.1 Employment data 2005 – as percentage of total employment

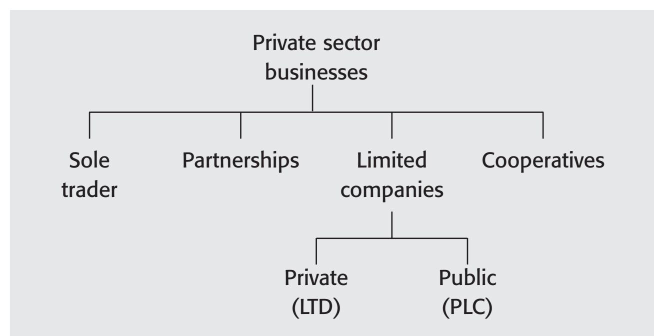

Figure 1.1 The private sector – legal structure

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and, in return, has full control of the business and is able to keep all of the profits. Although there is a single *owner* in this business organisation, it is common for sole traders to employ others, but the firm is likely to remain very small. Because of this, although they are great in number, sole traders account for only a small proportion of total business turnover. All sole traders have unlimited liability. This means that the owner's personal possessions and property can be taken to pay off the debts of the business, should it fail. This can discourage some potential entrepreneurs from starting their own businesses.

Another significant problem is to do with finance for expansion. Many sole traders remain small because the owner wishes to remain in control of their own business, but another reason is the limitations that they have in raising additional capital. As soon as partners or shareholders are sought in order to raise finance, then the sole trader becomes another form of organisation altogether. In order to remain a sole trader the owner is dependent on own savings, profits made and loans for injections of capital.

This type of business organisation is most commonly established in the construction, retailing, hairdressing, car-servicing and catering trades. The advantages and disadvantages of this form of organisation are summarised in Table 1.2.

Partnerships These are formed in order to overcome some of the drawbacks of a sole trader. They are agreements between two or more people to carry on a business together, usually with a view to making a profit. The agreement to work together does not create a separate legal unit; a partnership is just a grouping of individuals. When planning to go into partnership it is important to choose business partners carefully – the errors and poor decisions of any one partner is considered to be the responsibility of them all. This also applies to business debts incurred by one partner – in most countries there is unlimited liability for all partners should the business venture fail. In the UK, it is possible to set up limited liability partnerships.

It is usual, although not a legal requirement, to draw up a formal Deed of Partnership between all partners. This would provide agreement on issues such as voting rights, the distribution of profits, the management role of each partner and who has authority to sign contracts.

Partnerships are the most common form of business organisation in some professions, such as law and accountancy. Small building firms are often partnerships too. Many other owners of businesses prefer the company form of organisation and these are considered next.

The advantages and disadvantages of partnerships are summarised in Table 1.3.

Advantages	Disadvantages
◆ Easy to set up – no legal formalities. ◆ Owner has complete control – not answerable to anybody else. ◆ Owner keeps all profits. ◆ Able to choose times and patterns of working. ◆ Able to establish close personal relationships with staff (if any are employed) and customers. ◆ The business can be based on the interests or skills of the owner – rather than working as an employee for a larger firm.	◆ Unlimited liability – all of owner's assets are potentially at risk. ◆ Often faces intense competition from bigger firms, for example food retailing. ◆ Owner is unable to specialise in areas of the business that are most interesting – is responsible for all aspects of management. ◆ Difficult to raise additional capital. ◆ Long hours often necessary to make business pay. ◆ Lack of continuity – as the business does not have separate legal status, when the owner dies the business ends too.

Table 1.2 Sole trader organisations

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Advantages	Disadvantages
◆ Partners may specialise in different areas of business management. ◆ Shared decision making. ◆ Additional capital injected by each partner. ◆ Business losses shared between the partners. ◆ Greater privacy and fewer legal formalities than corporate organisations (companies). ◆ New ideas injected into the business.	◆ Unlimited liability for all partners (with some exceptions). ◆ Profits are shared. ◆ There is, as with sole traders, no continuity and the partnership will have to be reformed in the event of the death of one of the partners. ◆ All partners are bound by the decisions of any one of them. ◆ Not possible to raise capital from selling shares. ◆ A sole trader, taking on partners, will lose independence of decision making.

Table 1.3 Partnerships

Limited companies There are three distinct and important differences between companies and the two forms of 'unincorporated' business organisations that we have just studied. These are:

1 *Limited liability.* The ownership of companies is divided into small units called shares. People can buy these and become 'shareholders' – part owners of the business. It is possible to buy just one share but usually these are owned in blocks, and it is possible for one person or organisation to have complete control by owning more than 50% of the shares. Individuals with large blocks of shares often become directors of the business. All shareholders benefit from the advantage of limited liability. The only liability – or potential loss – a shareholder has is the amount paid for the shares. Nobody can make any further claim against shareholders, should the company fail. Liability is limited to the shareholding. This has two important effects:
   - people are prepared to provide finance to enable companies to expand,
   - the greater risk of the company failing to pay its debts is now transferred from investors to creditors (those suppliers/lenders who have not been paid). Creditors, as a result, are very interested in both ensuring that the word 'limited' appears in the company name and scrutinising the company's accounts for signs of potential future weakness.

2 *Legal personality.* A company is recognised in law as having a legal identity separate from that of its owners. This means, for example, that if the foods sold by a company are found to be dangerous or faulty, the company itself can be taken to court – not the owners, as would be the case with either a sole trader or a partnership. A company can be sued and can itself sue through the courts. This does not take all legal responsibilities away from the managers and owners. For example, directors can be legally responsible if they knowingly continue trading with a company that is illiquid. They must still act responsibly and in accordance with the stated aims of the business and within the law.

3 *Continuity.* In a company, the death of an owner or director does not lead to its break up or dissolution. All that happens is that ownership continues through the inheritance of the shares, and there is no break in ownership at all.

Private limited companies The protection that comes from being a company is therefore substantial. Small firms can gain this protection when the owner(s) create a private limited company. The word 'Limited' or 'Ltd'

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('Pte' in some countries) tells us that the business has this legal form. Usually the shares will be owned by the original sole trader, relatives, friends and employees. The former sole trader often still has a controlling interest. New issues of shares cannot be sold on the open market and existing shareholders may only sell their shares with the agreement of the other shareholders. Certain legal formalities must be followed in setting up such a business and these are explained in the section after public limited companies.

The advantages and disadvantages of private limited companies are summarised in Table 1.4.

Public limited companies These can be recognised by the use of 'plc' or 'inc.' after the company name. It is the most common form of legal organisation for really large businesses, for the very good reason that they have access to very substantial funds for expansion. A plc has all the advantages of private company status plus the right to advertise their shares for sale and have them quoted on the Stock Exchange. This not only means that public limited companies can raise potentially very large sums from public issues of shares but that existing shareholders may quickly sell their shares if they wish to. This flexibility of share buying and selling encourages the public to purchase the shares in the first instance and thus invest in the business.

The other main difference between private and public companies concerns the 'divorce between ownership and control'. As was explained above, the original owners of the business are usually still able to retain a majority of shares and continue to exercise management control when it converts to private company status. This is most unlikely with public limited companies, due to the sheer volume of shares issued and number of people and institutions as investors. These shareholders own the company, but they appoint, at the Annual General Meeting, a Board of Directors who control the management and decision making of the business. This clear distinction between ownership and control can lead to conflicts, for example over the objectives to be set and direction to be taken by the business. The shareholders might prefer measures that aim at short-term profits whereas the directors may decide to aim for long-term growth of the business, perhaps in order to increase their own power and status.

Many private limited companies convert to plc status for the reasons given below. It is not unknown for the directors or the original owners of a business to convert it back from plc to private limited company status. Richard Branson and the Virgin group is one of the best-known examples. The reasons for doing this are largely to overcome the divorce between ownership and control – in a private limited company it is normal for the senior executives to be the major, majority shareholders. In addition, the owner of a private limited company can take a long-term planning view of the business. It is often said that the major investors in a plc are only interested in short-term gains. 'Short-termism' can be damaging to the long-term investment plans of a business.

A summary of the advantages and disadvantages of public limited companies is given in Table 1.5.

Advantages	Disadvantages
◆ Shareholders have limited liability. ◆ Separate legal personality. ◆ Continuity in the event of the death of a shareholder. ◆ Original owner is still often able to retain control. ◆ Able to raise capital from sale of shares to family, friends and employees. ◆ Greater status than an unincorporated business.	◆ Legal formalities involved in establishing the business. ◆ Capital cannot be raised by sale of shares to the general public. ◆ Quite difficult for shareholders to sell shares. ◆ End of year accounts must be sent to Companies House – available for public inspection there (less secrecy over financial affairs than sole trader or partnership).

Table 1.4 Private limited companies

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