

IGCSE

Types of Business Activity

www.igcsebusiness.co.uk

Chapter 2



Business Studies

Levels of Economic Activity

- ☞ You would much rather be by the sea, lounging on this exceptional chair and drinking an ice cold smoothie...



- ☞ How many different stages came about to bring this exceptional chair to life?

Levels of Economic Activity

Stage

Primary



Business involved

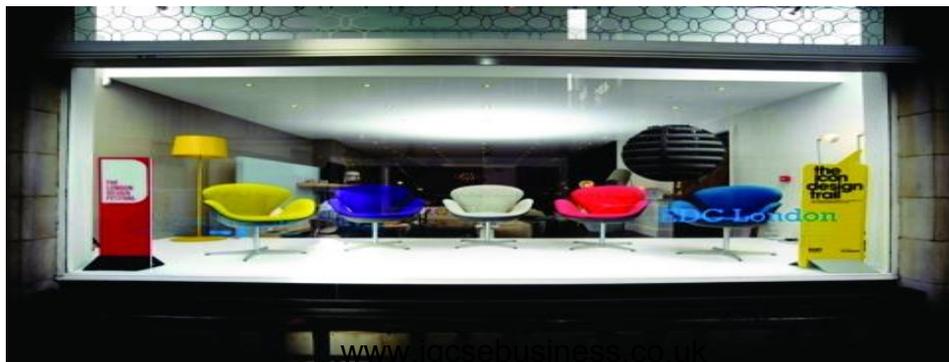
Woodcutter

Secondary



Furniture maker

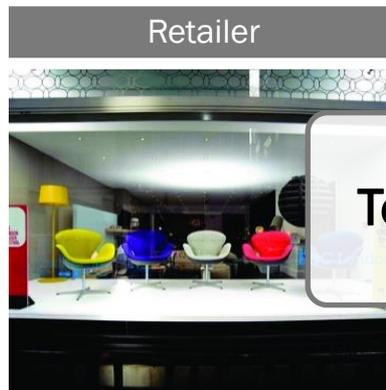
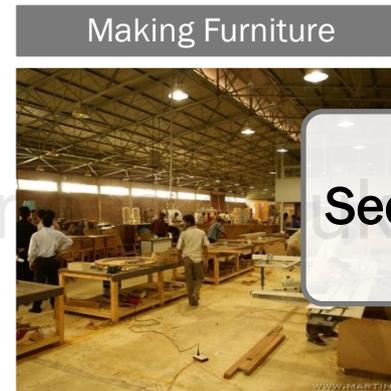
Tertiary



Retailer

Levels of Economic Activity

∞ ... You will notice that there are three main stages of activity.



Levels of Economic Activity

Stage 1: Primary Stage

- ☞ The primary sector of industry extracts and uses the natural resources of the earth.

www.igcsebusiness.co.uk



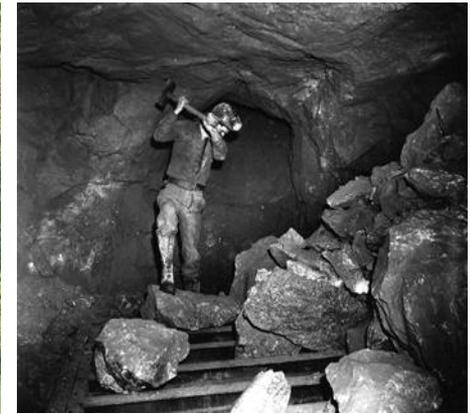
Farming



Fishing



Forestry



**Extraction of
natural
resources**

Levels of Economic Activity

Stage 2: Secondary Stage

- ☞ The secondary sector of industry manufactures goods using the raw materials provided by the primary sector.

www.igcsebusiness.co.uk



**Building &
Construction**



**Aircraft
Making**



**Clothes
Manufacturing**



Baking

Levels of Economic Activity

Stage 3: Tertiary Stage

- ☞ The tertiary sector of industry involves **providing services** to both consumers and other businesses. Activities in the tertiary sector include transport, banking, insurance, hotels and hairdressing.

www.igcsebusiness.co.uk



Transportation



Hotels



Hairdressers



Banking

Which sector is most important in your country?

- ☞ Every country is unique.. Therefore the term 'important' is relative to the needs of each individual country.
- ☞ The three sectors of industry are compared by

The number of workers employed in each sector

OR

The value of output of the goods and service



Levels of Economic Activity

While comparing countries, differences might occur...

Country	Primary	Secondary	Tertiary
United Kingdom	2	20	78
China	44	24	32
Ghana	54	20	26

As a general rule of thumb: developing countries tend to engage in more primary Sector industries.

Why???

Most people live in the rural areas with low incomes.



Therefore, there is little demand for services such as transport, hotels and insurance.

Levels of Economic Activity

∞ In developed countries...

- Manufacturing started long ago
- Secondary and tertiary sectors are employed more
- Level of output in the primary sector is lower.
- In very wealthy countries, it is common that they export the manufactured goods from abroad.
- Most of the workers will be employed in the tertiary sector for services.

- This process is called **de-industrialization**. It occurs when there is a decline in the importance of the secondary, manufacturing, sector in a country.

Public and Private Sectors of Industry

- ∞ **All countries** suffer from the problem of **scarce resources!**
- ∞ To solve this problem, they use one of three economic systems:

- 1. Free Market Economy**
- 2. Command or Planned Economy**
- 3. Mixed Economy**

Public and Private Sectors of Industry

Free Market Economy

I. Features

- All resources are owned privately
- No government control over land, capital and labour
- Businesses produce to make a profit
- **Goods in high demand:** Are more profitable and so are produced more.
- **Goods in low demand:** Are less profitable and so are produced less.
- **Prices** of goods are therefore influenced by the demand and supply of those goods.

Public and Private Sectors of Industry

Free Market Economy

II. Advantages

- ☞ **Consumers** are free to choose what they want to buy.
- ☞ **Workers** are encouraged to work hard because:
 1. They keep most of their incomes
 2. Taxes are very low
- ☞ **Competition among businesses** keeps *prices low*.
- ☞ **New businesses** are encouraged to set up in order to make *profits*.

III. Disadvantages

- ☞ **Government** doesn't provide *public services* and so...
 - Only those who can afford it will benefit (education, health, transportation).
- ☞ **Government** doesn't *plan* or *control* the economy and so...
 - There can be many uncontrolled *booms* and *recessions*.
- ☞ **Businesses** might be encouraged to create *monopolies* in order to control all of the market for a product and increase prices.

Public and Private Sectors of Industry

Free Market Economy

There is no country with a completely free market system. In all countries, governments are involved in important economic decisions, to a greater or lesser degree.

www.igcsebusiness.co.uk

The USA is the closest example to a free market economy

Public and Private Sectors of Industry

Mixed Economy

I. Features

- Combines some features of both a free market economy and a command economy.
- Nearly every country in the world has a mixed economy with both a ***private sector*** and a ***public sector***.



Public and Private Sectors of Industry

Mixed Economy

II. Private Sector

- ☞ Comprised of **businesses** *not owned* by the government.
- ☞ The **businesses** will decide about *what to produce, how it should be produced and what price should be charged for it.*
- ☞ Most businesses aim to run for **profit.**

III. Public Sector

- ☞ Made up of **government or state owned and controlled businesses and organizations.**
- ☞ The **government** makes decisions about *what to produce and how much to charge consumers.*
- ☞ Some *goods and services* are **provided free of charge** to the consumer such as *health and education services.*
- ☞ The money comes from **taxes.**
- ☞ **Service to the community** is the main objective.

Free Market Economy

All resources are owned by the private sector. Profit motive is very important.

Command or Planned Economy

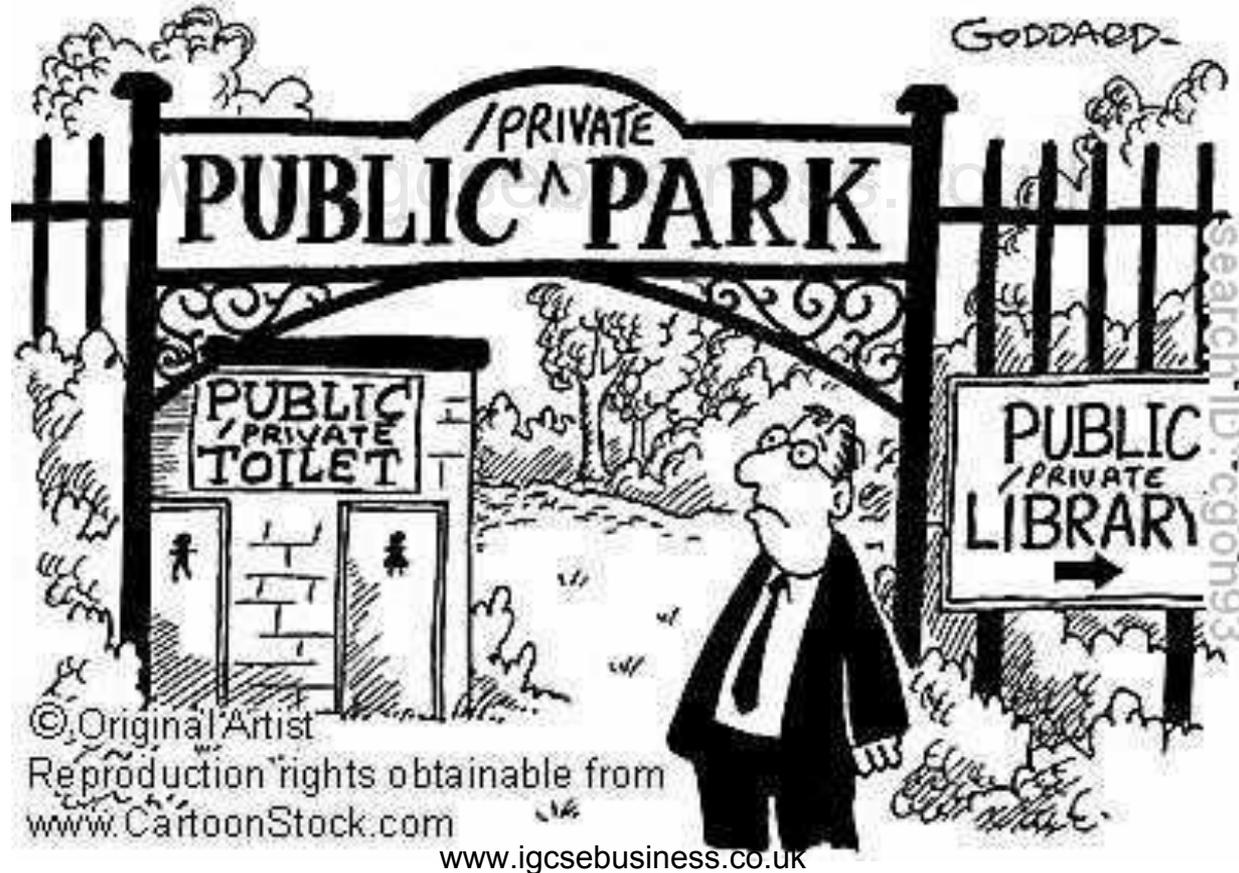
All resources owned and controlled by the state

Mixed Economy

Private Sector: Some private ownership and control.
Public Sector: Some state ownership and control.

Privatisation

Should the government own and control less than it does?



Privatisation

Privatisation is when governments have sold off businesses they previously owned to new owners in the private sector.

www.igcsebusiness.co.uk



Privatisation

Arguments for

- ∞ The new private owners are now aiming for **profit**. This increases **efficiency**.
- ∞ **Competition** may now be encouraged if the business is sold off to a variety of private owners. This helps to increase efficiency and so will keep **prices low**.
- ∞ **Governments** are often short of money. New owners will **invest additional capital** to improve the services.
- ∞ Important business decisions will now be made for reasons of business efficiency– not by government popularity.
- ∞ Sales of the public sector businesses raises money for the government for other services.



Privatisation

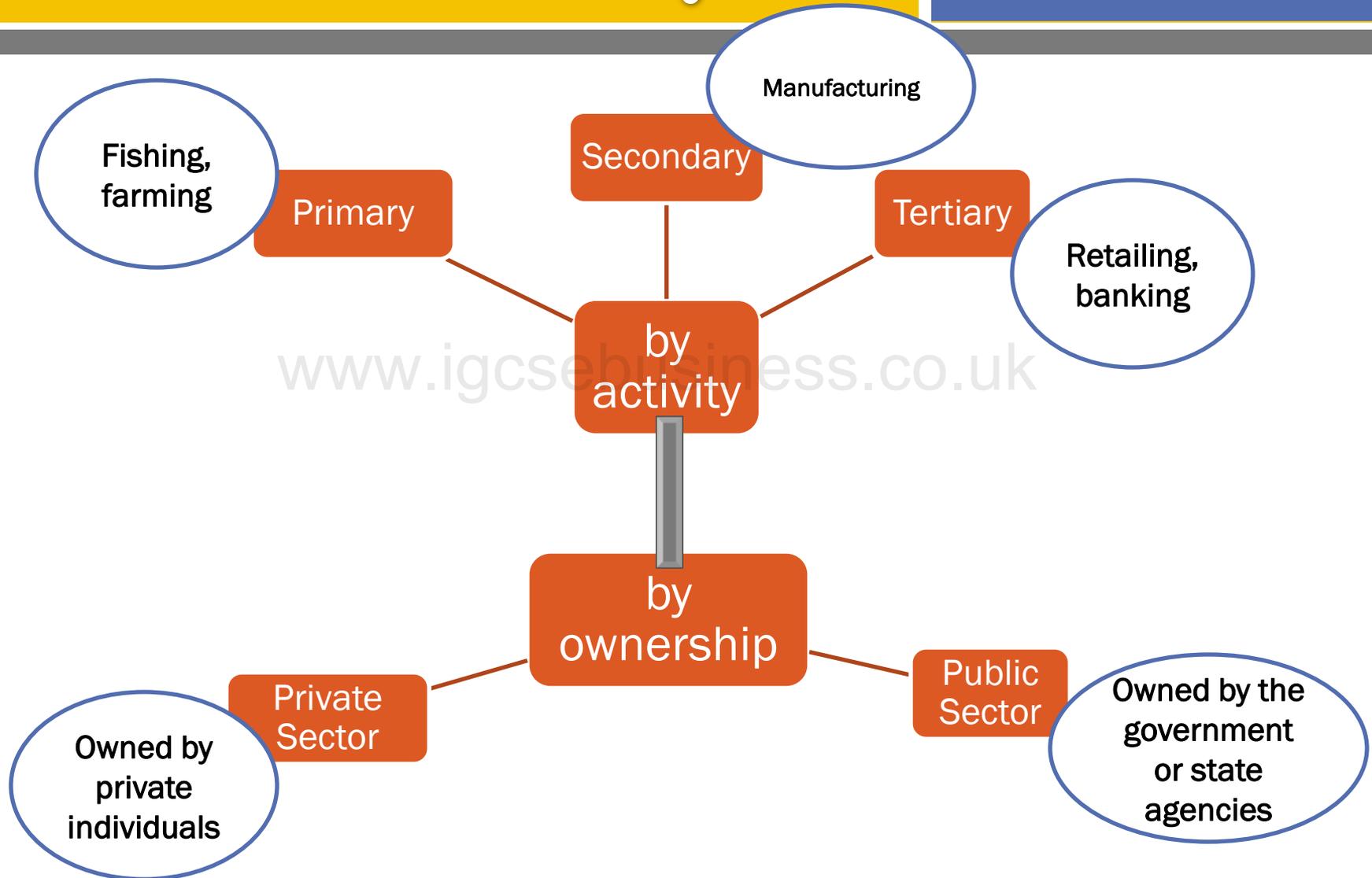
Arguments against



- As the new owners are interested mainly in profits, some **services making losses may be closed**. These might be disturbing to members of the community.
- Workers jobs could be lost as the new owners attempt to increase efficiency in order to raise profits.
- The business might be sold off to one owner who would still be able to run it as a **monopoly**. This could lead to **higher prices** for the customers.
- Only a few people – the new owners – will benefit from owning the business, whereas public services allow the entire community to benefit.

Sectors of Industry

Revision Summary



www.igcsebusiness.co.uk

Comparing the size of businesses

Businesses can vary greatly in terms of size

Can be owned and run by a single individual

OR

Can employ hundreds of thousands of workers all over the world



Comparing the size of businesses

Who would find it useful to compare the size of businesses?



Comparing the size of businesses

- Before deciding which business to put their savings into.

Investors



- Different tax rates for small and large businesses.

Governments



- Compare the size and importance with other firms.

Competitors



- To have some idea if how many people they'll be working with.

Workers



- To see how important a loan to the business is compared to its overall size

Banks



Comparing the size of businesses

1. NUMBER OF EMPLOYEES



2. VALUE OF SALES AND OUTPUT

3. CAPITAL EMPLOYED



Comparing the size of businesses

1. NUMBER OF EMPLOYEES

∞ Rule of thumb is that the bigger the business, the higher the number of employees.

∞ HOWEVER... Some firms use production methods which employ very little employees. These firms are called ***capital intensive firms.***



Comparing the size of businesses

2. VALUE OF SALES AND OUTPUT

- ☞ Rule of thumb is that we compare businesses of the same industry to see who's products are sold the most.
- ☞ HOWEVER... a very profitable firm might be employing very few employees.



Comparing the size of businesses

3. CAPITAL EMPLOYED

- ☞ Rule of thumb is that we compare the total amount of capital invested in the business.
- ☞ HOWEVER... a company may use **labour-intensive** methods of production to give low output and use little capital equipment.



Comparing the size of businesses

4. PROFIT

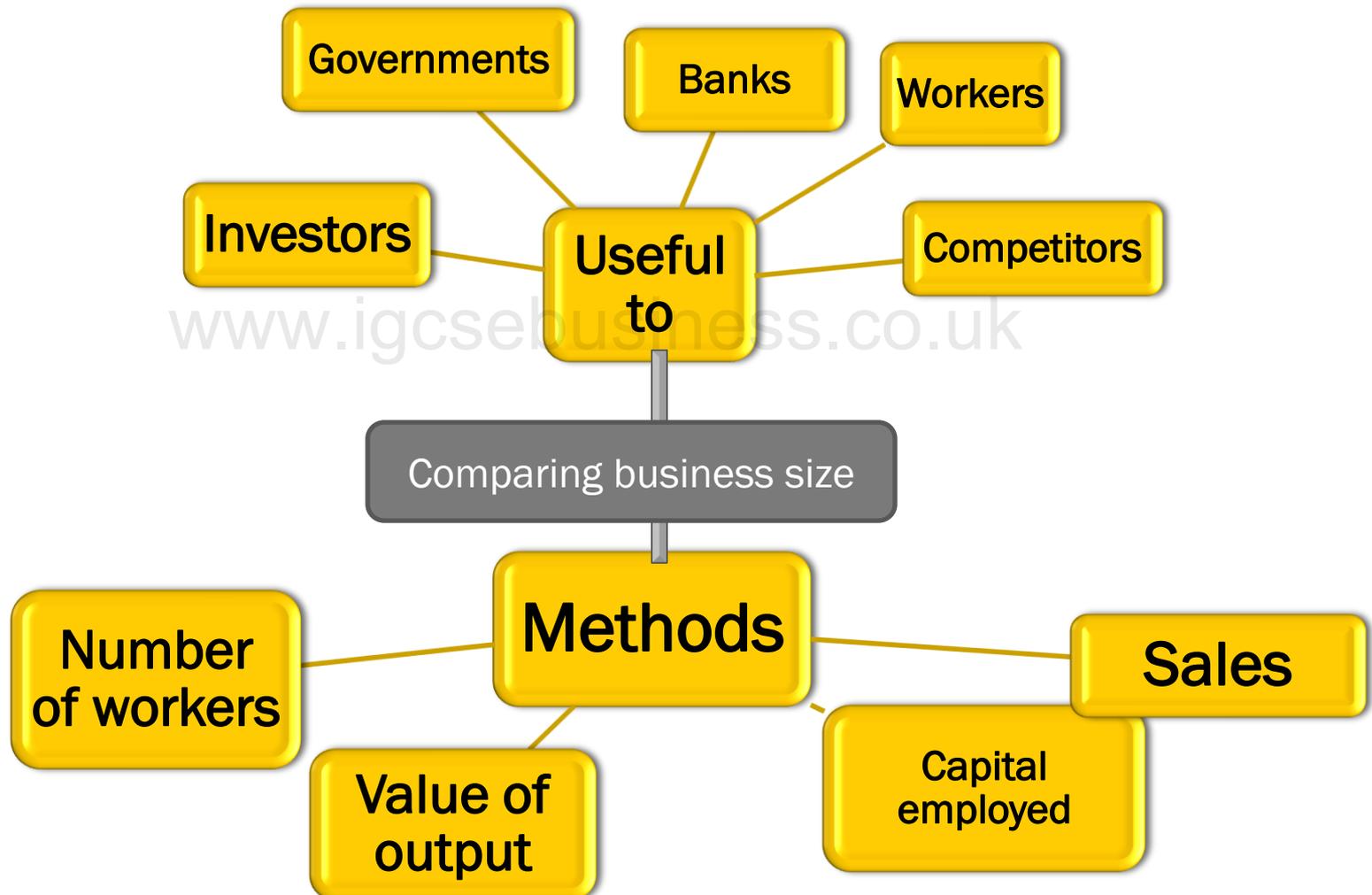
∞ THIS IS NOT AN ACCURATE WAY OF COMPARING THE SIZE OF FIRMS.

www.igcsebusiness.co.uk

∞ HOWEVER... it can be used as a measurement of **efficiency** when compared with the other methods, to justify employing certain techniques.

Comparing Business Size

Revision Summary



How can businesses grow (expand) ?

- ∞ Growth (expansion) is one of the main objectives of a business.
- ∞ Advantages of growth include:
 - ✓ **Owners:** Possible higher profits.
 - ✓ **Owners and Managers:** More status and prestige as well as salaries to the managers.
 - ✓ Economies of scale (chapter 6)
 - ✓ Controls **larger share of the market** (higher sales), creates more influence when dealing with suppliers and distributors

How can businesses grow (expand) ?

∞ Businesses can expand in two main ways

1

Internal Growth

- For example: a restaurant owner opening other branches of the same restaurant in other parts of town.
- Existing profits are regenerated for this kind of growth.

2

External Growth

- Involving a **Takeover** or **Merger** with another business

How can businesses grow (expand) ?

External Growth:

1. Horizontal Merger



- ∞ Horizontal Merger (Horizontal Intergration) is when one firm merges with or takes over another one in the **same industry** at the **same stage of production**.
- ∞ For example:
 - Glaxo Wellcome and Smithkline Beecham were two individual pharmaceutical companies that merged to become Glaxo Smithkline.
 - Sony and Ericsson were two high-tech electronics companies that merged to become Sony Ericsson.
 - Daimler-Benz (Mercedes) and Chrysler are two automotive companies that merged to become Daimler-Chrysler.

How can businesses grow (expand) ?

External Growth:

1. Horizontal Merger

∞ Advantages include

- ✓ The number of competitors is reduced
- ✓ There are opportunities for economies of scale
- ✓ The combined businesses will have a bigger share of the total market than either firm before the integration

How can businesses grow (expand) ?

External Growth:

2. Vertical Merger

- ∞ Vertical Merger (Vertical Intergration) is when one firm merges with or takes over another one in the same industry but at a different stage of production.
- ∞ It could be:
 - **Forward:** When a firm integrates with another firm at a later stage of production (*closer to the consumer*)
 - **Backward:** When a firm integrates with another firm at an earlier stage of production (*closer to the raw materials*)

How can businesses grow (expand) ?

External Growth:

2. Vertical Merger

∞ For example:

Raw
materials

Backward
Integration

- Coal Mine
- Copper Wire Maker
- Electrical Contractor

Forward
Integration

Consumers

- Real life example: ExxonMobil was initially Exxon (oil refinery) and Mobil (sale of oil refined products) that now form the #1 Forbes 2012 company worth \$828 billion.

How can businesses grow (expand) ?

External Growth:

2. Forward Vertical Merger

- ∞ Assume that a car manufacturer takes over a car retailing business
- ∞ Advantages include:
 - ✓ The merger gives an assured outlet for their product
 - ✓ The profit margin made by the retailer is absorbed by the expanded business
 - ✓ The retailer could be prevented from selling competing makes of car
 - ✓ Information about consumer needs and preferences can now be obtained directly by the manufacturer

How can businesses grow (expand) ?

External Growth:

2.Backward Vertical Merger

- ∞ Assume that a car manufacturer takes over a firm supplying car body panels
- ∞ Advantages include:
 - ✓ The merger gives an assured supply of important components
 - ✓ The profit margin of the supplier is absorbed by the expanded business
 - ✓ The supplier could be prevented from supplying other manufacturers
 - ✓ Costs of components and supplies for the manufacturer could be controlled.

How can businesses grow (expand) ?

External Growth:

3. Conglomerate Merger

- ∞ Conglomerate Merger (Conglomerate Intergration) is when one firm merges with or takes over another one in a completely different industry. This is also known as ***diversification***.
- ∞ For example:
 - General Electric over the years has merged and acquired a number of businesses to have expanded in many fields such as electronics, food products, medical technology products, etc.

How can businesses grow (expand) ?

External Growth:

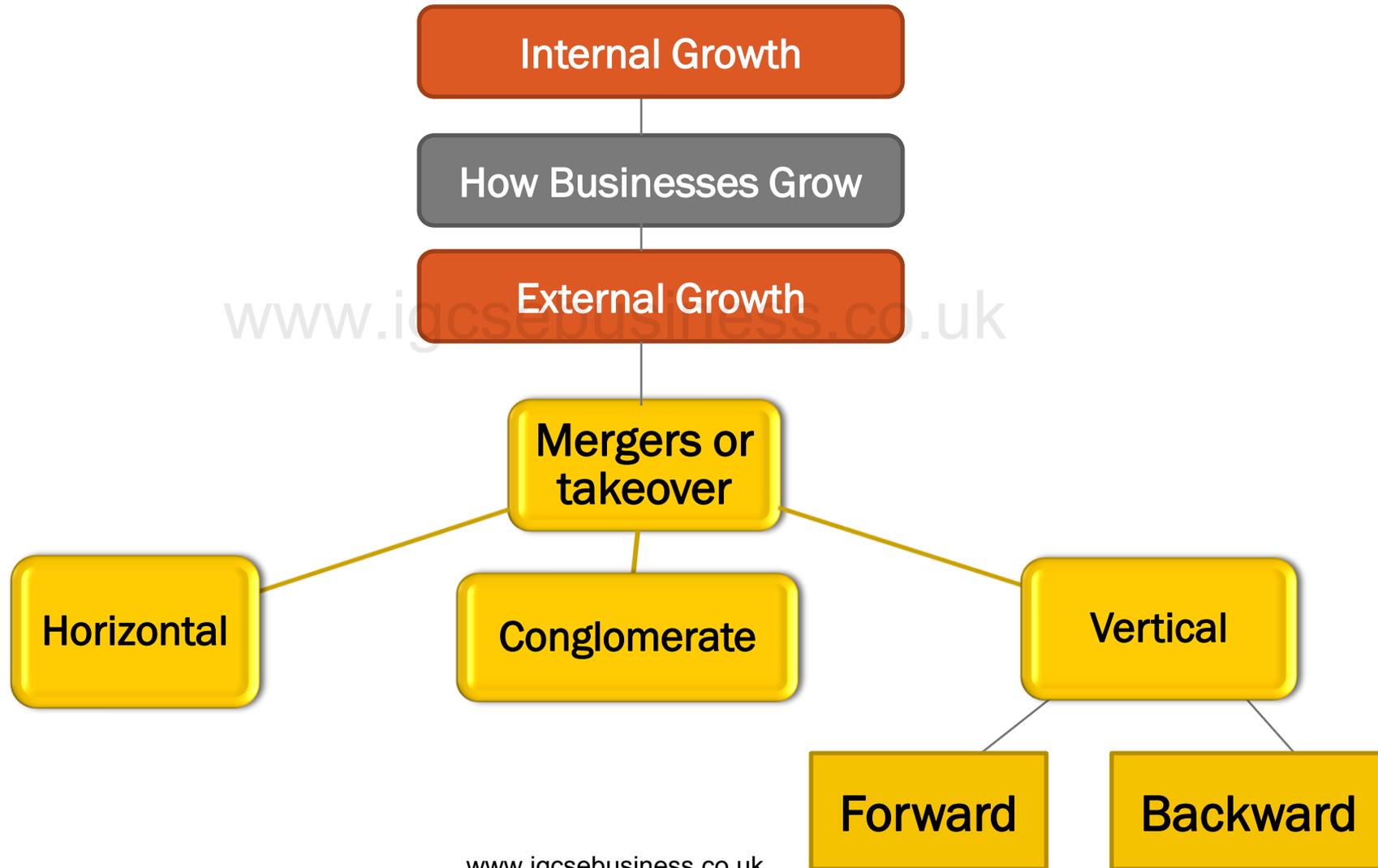
3. Conglomerate Merger

∞ Advantages include

- ✓ Spreading the risks over several activities
- ✓ Transfer of ideas between the different sections helping employees and managers to look outside the box.

How Businesses Grow

Revision Summary



Why do some businesses stay small?



- ∞ Not all businesses grow... some stay small (employ relatively fewer people and use relatively smaller amounts of capital)
- ∞ There are several reasons for this...
 1. The type of industry the business operates in
 2. The market size
 3. The owners' objective

Why do some businesses stay small?

1. The type of industry the business operates in

- ∞ Some businesses offer personal services or specialized products...
- ∞ If they were to grow too large, they would find it difficult to offer the close and personal service demanded by the consumers.
- ∞ For example...



Why do some businesses stay small?

2. Market Size

- ∞ If the market – the total number of customers – is small, then the business is likely to remain small.
- ∞ For example...



Why do some businesses stay small?

3. Owners' Objectives

- Some business owners prefer to keep things small and simple. They run a cozy business that they are in control of, know all of their employees and wish to avoid the added stress of running a larger firm.

Booklet Past Papers

www.igcsebusiness.co.uk



Model Answers

Booklet Past Papers: Model Answers

The government of country A has recently collected data concerning the **business sectors** of the country. Table 1 shows this data.

Table 1

Sector	% of total employment	% of total GDP
Primary	50	30
Secondary	40	45
Tertiary	10	25

GDP measures the **value of the total output** produced in a country in one year. In 2004 the **GDP of country A was \$1800m.**

Table 2

Number of Employees	% of businesses
Less than 10	40
10-100	45
Greater than 100	15

2 marks

The **number of employees in country A in 2004 was 15m.**

Booklet Past Papers: Model Answers

a) Using **Table 1** calculate:

Table 1

Sector	% of total employment	% of total GDP
Primary	50	30
Secondary	40	45
Tertiary	10	25

i. The **number of people** employed in **Tertiary activities**.

Number of people employed in Tertiary activities = Total number * Percentage of total employment

Number of people employed in Tertiary activities = $15\text{m} * 10\% = 1.5 \text{ m people}$.

2 marks

ii. The **value of the output** of the **Primary sector** of the economy.

Value of output in Primary sector = Total GDP * Percentage of total GDP

Number of people employed in Tertiary activities = $\$1800\text{m} * 30\% = \540 m

2 marks

Booklet Past Papers: Model Answers

- b) Table 2 shows the size of businesses by the number of people employed. Is using the number of employees to measure business size the best method? Explain your answer.

Table 2

Number of Employees	% of businesses
Less than 10	40
10-100	45
Greater than 100	15

As a rule of thumb, when we measure businesses using the number of people employed, the larger business will have the higher number of employees or labour force. The opposite is also, nevertheless true. This may be misleading since some businesses are capital intensive which means that they rely more on machinery that can replace the presence of actual people. The machines allow these businesses to have an increase in productivity, become more efficient and hence need less laborers. This does not necessarily make them small in size. Therefore, we cannot rely on number of employees only as a rule since there are other factors such as the capital invested and value of the sales and output.

Booklet Past Papers: Model Answers

Mirex is a large company that sells a range of **insurance policies** to businesses and the general public. The market for insurance is very **competitive** and Mirex are always looking for ways to **cut their costs**. Recently they have invested heavily in **new technology**.

a) Mirex has been described as a large company. **State three** ways of measuring the size of a business.

1. By measuring the number of employees in a business.
2. By measuring the value of the output and sales.
3. By measuring the capital invested in the business.

3 marks

b) What **sector of business activity** does Mirex operate in. **Explain your answer**.

Mirex operates in the tertiary sector. This is because they sell insurance which is a service that they provide to businesses and the general public. Services are part of the tertiary sector.

2 marks

Booklet Past Papers: Model Answers

Country X has a mixed economy. It also has businesses in the primary, secondary and tertiary sectors.

a) Give an example of a business in:

- i. The primary sector: fishing, farming, mining. *(mention only one)*.
- ii. The tertiary sector: insurance, banking, hotel services *(mention only one)*

1 mark

1 mark

b) Explain what is meant by the term 'mixed economy'.

A mixed economy combines some features of a free market economy (no government interference) and a command economy (government controls the decision-making).

A mixed economy has two sectors working together for the overall benefit of the community. There is the public sector which consists of government or state aimed businesses with the primary aim of providing a service to the community and consumers. This may include transportation systems, public school and public hospitals as well as police systems.

The private sector includes businesses not owned by the government which make their own decisions about what to produce, how to produce it and the selling price. The main aim for these businesses is to make a profit.

4 marks

Booklet Past Papers: Model Answers

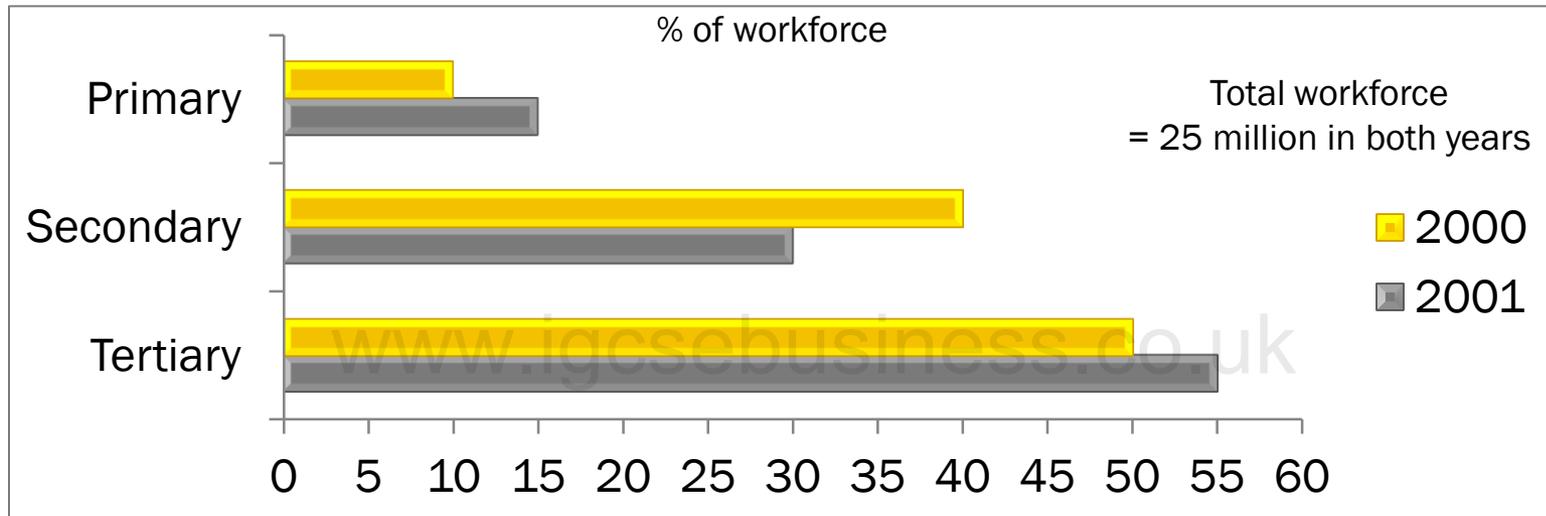


Fig. 1

- a) Use the data given in Fig. 1,
- i. State the % of workforce employed in primary activities in 2000.

10%

1 mark

Booklet Past Papers: Model Answers

a) Use the data given in Fig. 1,

ii. Calculate the number of people employed in tertiary activities in 2001.

$$\begin{aligned}\text{Number of ppl in tertiary act. in 2001} &= \text{Total workforce} * \% \text{ of tertiary act. in 2001} \\ &= 25\text{m} * 55\% \\ &= \underline{13.75 \text{ m people}}\end{aligned}$$

2 marks

www.igcsebusiness.co.uk

b) Explain why, in many countries, the percentage of the workforce employed in tertiary activities is increasing.

The tertiary sector is concerned with the services industry. This includes insurance, hotels, restaurants and the banking sector. As the economic activities increases in many countries, the standard of living will rise in that country for the people. When this happens, most of the basic needs will be met and the consumers will start piling up their wants lists. Consumers will start looking for more luxurious services and products to satisfy those wants, which opens up the room for industries in the tertiary sector to set up and supply those demands.

Booklet Past Papers: Model Answers

c) Two large drink manufacturing companies have just merged creating a monopoly.

i. What is meant by a monopoly?

A monopoly is a business which controls all of the market for a product. In this case, when the two drink companies have merged, they eliminated each others' competition causing them to join forces and become one company controlling this market.

2 marks

ii. Explain what advantages the companies would expect to gain from this merger.

This type of merger is a horizontal merger because it takes place with industries in the same stage of production. The merger has reduced the number of competitors in the market. Instead of the two large firms competing with each other, they are joining forces to become one large company that will benefit from the profits of all the products. They will be producing at a lower cost as well since they will take advantage of the economies of scale. The new business will have a higher market share, higher control over the market and so again will have achieved its profit and growth objectives.

4 marks

Booklet Past Papers: Model Answers

c) A market economy exists in many countries. Identify the main features of such a system.

A market economy is one where the resources are owned by the private sector. There is no government control over the land, labor or the capital. The main objectives of businesses in a market economy is to produce profits. Decisions of what to produce and what services to supply in the markets are a result of the demand placed by the consumers. The higher the demand, the more profitable the business and so the higher the production and investment.

Consumers have a lot of options to choose from since this type of market encourages many business owners to set up their businesses there, since there are little or no taxes to be paid leading to higher profits.

The main concern of a market economy is that the complete absence of governmental control can lead to monopolies, unplanned recessions and booms as well as unregulated market activity. Also, services that are essential for individuals such as health care and education are only available to those who can afford it.

Booklet Past Papers: Model Answers

In some countries a number of state owned businesses have been sold to the private sector (privatisation). State and explain **two** possible disadvantages to consumers of this.

The main disadvantage of privatisation is that the objectives of the private sector are not the same as those of the public sector. The private sector is more concerned with making a profit while the public sector is more concerned with providing a service to the community. Decision-making will therefore take a different approach since the new private sector company will cut down on losses to maximize profits via shutting down services, letting workers go and increasing prices.

Another disadvantage is that the business might be sold to one private investor who can turn it into a monopoly. A monopoly can take place when one business is in control of the majority of shares of the market. This will not benefit consumers since prices will rise and the absence of competition will not guarantee the maintenance of quality.

Booklet Past Papers: Model Answers

Table 1 gives employment data for country A over the last 10 years.

Table 1
Employment data for country A 1993-2002

	1993	2002
% of labour force employed in		
Primary Sector	21	14
Secondary Sector	45	40
Tertiary Sector	30	41
Unemployed as % of labour force	4	5
Labour force (millions)	80	84

- a) Calculate the number of people employed in secondary business activities in 2002.

No. of ppl in Secondary Business in 2002 = Total labour force * % of secondary act

$$= 84\text{m} * 40\% = \underline{\underline{33.6 \text{ m people}}}$$

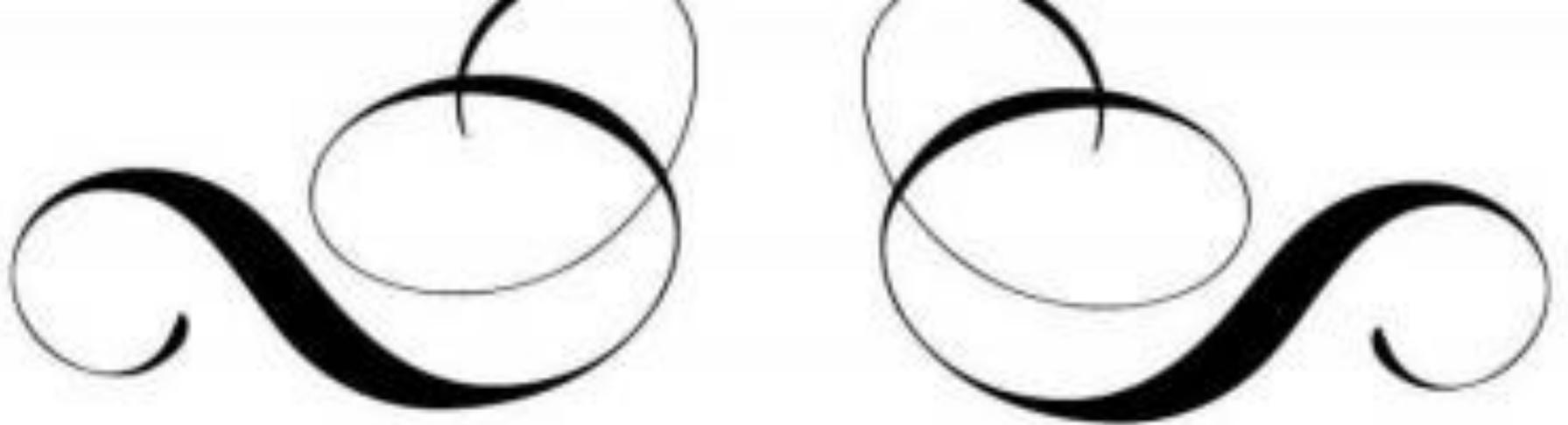
2 marks

Booklet Past Papers: Model Answers

- b) Outline **two** possible reasons to explain the changes in the pattern of employment between 1993 and 2002 in country A.

As countries move from becoming developing to developed countries, they start moving their activities from the primary and secondary industries and into the tertiary sector. This is because the standard of living of the people has increased which has caused most of their needs to be met. This allows demand for the tertiary sector services to increase, becoming more profitable for businesses and so the shift in sectors takes place.

De-industrialization takes place in the secondary sector, which is a decline in the importance of the manufacturing sector of industry. Countries can start exporting goods needed from the primary and secondary sectors now as their countries are becoming wealthier. This allows them to focus on the tertiary services and increase the activities to meet the demands of the consumers.



Thank You

