

## **S.5 ECONOMICS | PRODUCTION**

Production refers to the creation of utility to satisfy human needs.

Utility on the other hand refers to the ability of a commodity service to satisfy a need

It is measured in units referred to as Utils

Production can also be referred to as the transformation of inputs (raw materials) into finished products that can satisfy Human wants.

It is also referred to as the process of creation of goods and services aimed at satisfying human wants.

N.B

Production is incomplete until a commodity reaches the consumer.

Production of goods and services takes place in a given organisation such as a firm, a factory, an industry etc. Such organisations may be owned by an individual, a group of individuals or the Government.

### **LEVELS / CATEGORIES OF PRODUCTION**

There are three categories of production namely

1. Primary production
2. Secondary Production
3. Tertiary Production

### **PRIMARY PRODUCTION**

This refers to the extracts of Raw materials and from nature OR It is the extraction of raw materials made available by nature.

It involves activities like mining, fishing, hunting, lumbering, agriculture etc.

This stage of production is also referred to as the extractive stages of Production.

Its output is used as input in the Secondary Sector e.g. agricultural products like Sugar canes are used to make sugar.

### **SECONDARY PRODUCTION**

This stage involves transforming raw materials into finished products which satisfy human wants. It is comprised of all forms of manufacturing and construction.

- a) Manufacturing

This involves turning raw materials from primary stage into finished output. It involves activities like sugar making, fish processing, textile making, grain milling etc.

b) Construction

This involves using output from the primary stages to build physical structures. It involves activities like construction of dams houses, roads, bridges etc.

## TERTIARY PRODUCTION

This refers to the production/ provision of services. The output of primary and secondary production stages has to be transported from one place to another, stored, advertised etc. and such services are from the tertiary stage of production

There are two types of services offered

a) Personal / Direct services

These are services offered on a personal level e.g. teaching, treatment by doctors etc. such personal/ direct services are provided in person.

b) Commercial services./ Indirect services

These are services that are provided indirectly and they facilitate trade e.g. banking, transportation, warehousing, insurance, advertising etc.

They are usually carried out on a large scale.

## TYPES OF PRODUCTION

There are two types of production

1. Direct / subsistence production
2. Indirect / Commercial production.

### Direct / Subsistence production

This is a type of production where individuals produce goods and services for their own consumption.

OR

It refers to the production of goods and services for producer's own consumption e.g. subsistence farmers grow crops for their own benefit and not for sale

NB

It also referred to as non-market production

### Characteristic features of Subsistence production

1. It basically uses family members as workers
2. It mainly uses rudimentary / poor tools
3. There is mainly low output

4. Basically low quality is produced since there is no competition
5. There is basically limited specialization in products
6. Mainly barter system of trade is used.
7. There is basically absence of innovations

#### Advantages of Subsistence production

- It is cheap. This is because it uses the redundant family labour and it doesn't involve hiring expensive labour.
- It uses simple tools which can easily be acquired by the low income groups of people e.g. hand hoes, pangas, axes, etc.
- It is easy to manage. This is because it is usually carried out on small scale and requires limited managerial and supervision skills
- There is limited wastage of resources. This is because whatever is provided is consumed even the incidental surplus is sold through barter trade system to enable the producer get other basic requirements.
- There are no transport costs involved from the producing place to the market. This is because the producer happens to be the consumer.
- It is the major source of food in Uganda. Subsistence production is basically found in the agricultural sector and most households depend on food from this sector.

#### Disadvantages / Demerits

- It generates low income to the producer. Most of what is produced is for consumption and not for selling. The incidental surplus that is sold is limited thus leading to low income to the producers and hence limiting their welfare.
- There is low output / low productivity. This is because there is no motivation to work hard as the producers produce only the amount that is just enough for them.
- It limits capital accumulation. This is because of low productivity / low output which leads to low income leading to low savings and investments leading to low capital accumulation.
- It doesn't attribute to the national income. This is because output isn't marketed. It makes it hard to value output in the subsistence sector in order to be computed and included in the national income statistics.
- Low quality output is produced. This is because of absence of competition in production.
- There is little or no contribution to the government revenue. This is because the output is not marketed and is not subjected to taxation.
- There are limited inventions and innovations. This is because there is no competition and the producer produces for his own consumption.
- It discourages infrastructural development. This is because it discourages movement, transportation and storage facilities as the limited amount of output produced doesn't require such facilities.

## COMMERCIAL PRODUCTION / INDIRECT PRODUCTION / PRODUCTION FOR THE MARKET

This refers to the production of goods and services for sell. This is the kind of production in which output is basically meant for exchange and profits. It normally takes place in the modern sector and is profit motivated e.g. plantation farming, large-scale mining etc.

### Characteristics / Features of Commercial production

- It is basically organized on specialization basis.
- It basically uses modern methods of production (modern technology)
- Production is basically for the market.
- It is mainly profit motivated
- There is basically use of skilled and specialized labour
- It involves a lot of research in production.
- The exchange of output is basically done using money.

### Advantages / Merits of production

- High level of output is produced. This is because production is on large scale and it involves specialization.
- High quality output is produced. This is because commercial production uses skilled and specialized labour, involves use of modern machines and involves competition between producers.
- It facilitates infrastructural development i.e. the growth of the commercial sector and production requires existence of modern and efficient infrastructure such as better roads and storage facilities. Such infrastructure promotes other economic activities.
- It enables firms to enjoy economies of scale i.e. commercial production enables to enjoy the advantages of large scale production e.g. discounts on the purchases and reduced per unit cost of marketing the output produced.
- It contributes to the country's tax revenue i.e. commercial production activities are taxed by the government and such tax revenue is used to finance the government expenditure and provision of basic and social infrastructure.
- It promotes economic diversification, this is because it enables the spreading of production risks across many economic activities i.e. in case of failure of one economic activity the alternative activity supports the economy.
- It generates more employment opportunities. Commercial production is carried out on large scale which leads to creation many job opportunities in the country.
- It enables improvement of technology in the country. This is because it involves inventions and innovations. Better technology improves the quantity and quality of the output productions.

1 a) Distinguish between Subsistence production and subsistence output?

b) Mention any three demerits of a large subsistence sector in your country?

- Low quality output is produced
- Low tax revenue
- Low quality of output is produced.
- High levels of unemployment and under employment
- Limited specialization and trade
- Under exploitation / under utilization of resources.
- Limited inventions and innovations.

#### FACTORS OF PRODUCTION / AGENTS OF PRODUCTION

There are basically four factors of production namely:

- Land
- Labour
- Capital
- Entrepreneurship

NB: Factors / Agents of production are basic resources that are used in the production process.

OR.

They are inputs that firms or producers combine in different proportions to produce goods and services.

It should also be noted that each factor of production is paid a monetary reward for its contribution in the process called a factor price.

#### QNS

a) What is meant by the term factor prices?

These refer to the monetary rewards/ monetary payments to the factors of production for their contribution in the production process of goods and services.

b) Mention any three prices in economy

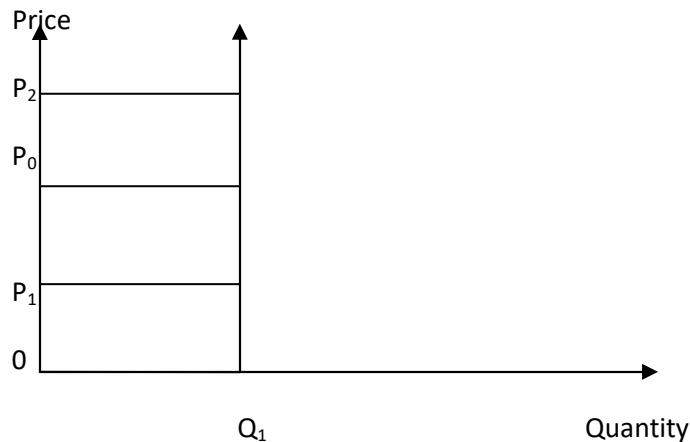
- Rent per land.
- Interest for Capital
- Wage for labour.
- Profit for entrepreneurship

#### LAND

Land refers to all gifts of nature man uses to produce goods and services. It includes things like agricultural land, minerals, rivers and lakes natural forests etc. it should be noted that the supply of land is fixed, and is not homogeneous (i.e. it is not of the same quality) and the reward is rent.

#### Characteristic features of land

- c) Land is fixed in supply i.e. the amount of land can't be increased or decreased.



- Land is a free gift of nature i.e. it is acquired at zero cost
- Land is occupationally mobile but geographically immobile.
- The productivity of land can be damaged i.e. it can be improved on or reduced
- Land is subjected to the law of diminishing returns.

#### Uses of land

- It is a source of a variety of human resources e.g. different minerals, timber fish, water etc.
- It is used for recreation e.g. it provides beautiful sceneries for leisure such as beaches,, game parks, sports grounds etc.
- It is useful for agricultural productions i.e. it supports farming and animal husbandry.
- It is used for settlement i.e. accommodation facilities and residential places are constructed on land

It should be noted that all payments towards land is Economic rent this is because land is a free gift of nature.

#### LABOUR

This refers to the physical ability or mental ability that is directed towards work and is paid for  
OR

It refers to the physical / mental efforts of human beings which are used in the production process.

OR

Labour refers to human efforts (mental and physical) that participates in the production process and is paid for.

Labour involves unskilled labour, semiskilled labour. The monetary reward to labour as a factor of production for its contribution in the process of products is referred to as a wage.

NB

Cooperant factors of labour: These are complementary factors of production that labour works with to produce and services

E.g. land and capital

### **Characteristics of labour**

- Labour is occupationally and geographically mobile
- Labour effort cannot be separated from the owner
- Labour is a variable factor of production and depends on a number of factors.
- The demand for labour is derived demand. i.e. labour is not demanded for its own sake but for the goods and services it helps to produce.

### **Labour supply**

This refers to the total number of people who are able and willing to work at a given wage rate in a given period of time or it refers to the number of hours that a worker / employee is offering at a given wage rate and at a given period of time.

Factors determining labour supply

- **The population size:** A big population size implies that there are more people that are able and willing to work leading to a high labour supply while a small size of the population means that fewer people are able and willing to offer services which leads to low population supply.
- **The health conditions of the workers / mental and physical ability of labour.** The employees that are physically and mentally strong (health workers) have a high labour supply because they have the energy to work for long hours while those who are mentally weak and unable to work for long hours.
- **The age composition of the population.** A population that comprises of mainly the young and the old ones lead to low labour supply because such people are unable to work while a population that comprises of mainly people in the working age brackets leads to high population supply.
- **Working conditions.** Good working conditions attract the working population and hence leading to high labour supply while poor working conditions discourage people from working leading to a low labour supply.

- **The nature of the job in terms of risks involved.** Jobs which are risky attract less hours of work which leads to low labour supply while less risky jobs attract high labour supply because a worker can work for many without any health complication.
- **The level of education and the training period.** A long training period keeps the workers at school for a longer period of time which leads to low labour supply because it makes people lose hours of work as they study while a short training period leads to a high labour supply because it enables the people to start working eagerly enough.
- **The attitude of the worker towards work.** A negative attitude towards work (e.g. laziness) leads to low labour supply while in a positive / good attitude towards work leads to high labour supply because the people are more willing and interested in the work
- **The political climate.** Politically stable areas encourage economic activities attract the working population hence leading to high labour supply but politically unstable areas discourage economic activities hence leading to low labour supply.
- **The rules governing the employment of women and children in a community.** Women's children are poor allowed to work there is high labour supply because many people are available for work when women and children are both allowed to work there is low labour supply.
- **The retirement age.** A high retirement age leads to high labour supply because it involves many people in the working age group while a low retirement age leads to a low labour supply because it restricts many people from work.
- **The working age (the age of which people are allowed to start working).** The higher the working age, the lower the labour supply because less of the people will be allowed to work while the lower the working age, the higher the labour supply.
- **The influence of trade unions.** Presence of trade unions creates a good attitude towards work among the workers and it attracts labour leading to a high labour supply while absence of trade unions leads to a low labour supply.
- **The rate of migration of labour (immigrants and emigrants).** High levels of immigration implies that people are coming into the country which leads to a high labour supply while high levels of emigrants leads to low labour supply because any people are moving out of the country which reduces the number of people that are available for work hence low labour supply.
- **There sex composition are the population of a country.** A country with more females than males tends to have low labour supply this is because traditionally domestic work takes a lot of time from women and also females are basically weaker than males while a country with more than women leads to a high labour supply because men are generally stronger and are rarely involved in domestic work.



## Demand for labour

Demand for labour refers to the number of workers / employees that the employers are willing to offer jobs at the given wage rate and given time.

### Factors determining demand for labour

- **The level of wages.** Other factors held constant, the higher the wages, the lower the demand for labour because labour is expensive and the employers opt for cheaper capital intensive technology (employing machines) while the lower the wage rate, the higher the demand for labour since the employers find it cheaper to hire labour than any other production technique..
- **The level of demand for the products that are produced by labour.** The higher the demand for the products of labour, the higher the demand for labour so as to meet the customers' desires and the lower the demand for the products of labour, the lower the demand for labour since the products produced are not so much needed by the consumers.
- **The productivity of labour depending on the skills, health of the workers.** The more the productivity of labour is, the higher the demand for labour since it contributes greatly to the total earnings of the firm while the lower the productivity of labour the lower the demand for labour since it contributes less to the total earnings of the firm..
- **The percentage of the wage bill to the total costs of production.** The smaller the percentage of the wage bill to the total costs, the higher the demand for labour since the labour expenses can be met with ease while the higher the percentage of the wage bill to the total costs, the lower the demand for labour since labour becomes so expensive and therefore so costly to hire on the side of the employers..
- **The availability of the co-operant factors of production that complement labour in production of goods and services.** Where the co-operant factors of production are readily available, demand for labour is high since labour does not work exclusively while where the co-operant factors of production are scarce, demand for labour is low since labour has to work with other factors of production.
- **The price level and availability of the substitutes to labour.** The cheaper it is to use capital, the lower the demand for labour since the employer decides to use the capital that is cheaper so as to minimize costs however, if capital is scarce and therefore expensive to hire, the demand for labour is higher since then labour turns out to be cheaper to hire..
- **The level of skills that labour possesses.** Highly skilled and trained labour is on a higher demand since it is associated with higher productivity levels while semiskilled and unskilled labour has a lower demand since it is less productive and therefore it contributes less to the total revenue of the firm.
- **The type of technology / technique of production that is being used by the employer.** For example use of capital intensive technology leads to low demand for labour as the employer prefers to use more of machines than humans while use of labour intensive techniques of production leads to high demand for labour since the employer prefers to use more of humans than machinery most especially in those types of jobs that call for human judgement.

### **Exercise.( answer these questions)**

1. Explain the different causes of low labour demand in Uganda.
2. Under what circumstances may labour demand be high?

### **PRODUCTIVITY AND EFFICIENCY OF LABOUR.**

Labour productivity refers to the quantity of output that is produced by a unit of labour in a given period of time. E.g. given that 5 tailors can produce 25 skirts in one hour, calculate the labour productivity.

$$\begin{aligned}\text{Labour productivity} &= \frac{\text{total output}}{\text{No of workers}} \\ &= \frac{25 \text{ skirts}}{5 \text{ skirts}} \\ &= 5 \text{ skirts. i.e each unit of labour can produce 5 skirts in one hour.}\end{aligned}$$

Efficiency of labour on the other hand refers to the measure of the quantity and quality of output per each unit of labour (worker) in a given period of time. Therefore efficiency of labour looks at both the quantity and quality of output.

### **Factors that determine productivity of labour.**

- **The working conditions.** Good working conditions such as good sanitation, nice meal, well ventilated place etc. lead to high productivity of labour because labour is well motivated and therefore able to produce large volumes of goods and services while poor working conditions lead to low labour productivity since the poor working conditions kill the morale of the workers and they therefore end up producing few goods and services.
- **The level of experience.** Highly experienced workers tend to be more efficient in production since they have the expertise of carrying out a given task and therefore they produce large volumes of goods and services while workers who are having less experience, have less exposure in performing a given task and they therefore produce small volumes of goods and services.
- **The level of education and training of labour.** Well trained and educated labour is easy to instruct and as a result, likely to be more productive while less educated / less trained labour is not easy to instruct and therefore usually produces less few goods and services .
- **The wage given to labour.** A good wage rate leads to high productivity and efficiency of labour because workers are motivated and therefore can produce many goods while a low wage kills the morale of workers and they become less productive thereby producing few goods.
- **The social environment of workers.** Good social environment for example family stability, good employee-employer relationship etc leads to high productivity and efficiency of labour since labour is encouraged to work harder which results into greater output levels while a poor

social environment such as family conflicts and poor relationship between workers and employers leads to low labour productivity since such conflicts demotivate workers and also kill their morale to work hence producing few goods and services.

- **People's attitude toward work.** A positive attitude towards work makes one enjoy his or her own work and therefore becomes more productive hence high output levels while a negative attitude toward work, leads to low productivity of labour as it makes workers lazy and hence producing few goods.
- **The quality of management and supervision.** Good coordination and supervision of labour makes it more productive and hence greater output levels are produced while poor management and supervision of labour makes it less productive and hence few goods are produced.
- **The level of organisation of workers (the strength of trade and union of workers).** Workers with strong and organized trade unions tend to be more productive because they are more motivated and facilitated while workers who belong to weak and less organized trade unions are less productive and therefore produce few goods since such trade unions do not promote their interests well and this therefore kills the workers' morale to work.
- **The health conditions of the workers.** Workers under good health conditions have a high productivity level because with good health, labour is strong and therefore able to produce large volumes of goods and services while poor health conditions make labour physically weak and therefore less volumes of goods are produced.
- **Availability and quality of the other co-operant factors to labour.** Presence of enough co-operant factors that are of a good quality, enables labour to work at a high speed which leads to higher productivity of labour while presence of few co-operant factors to labour that are of a poor quality, leads to low labour productivity because they demotivate workers making them produce few goods and services.
- **The level of innovation and invention by the workers.** Workers who are highly innovative and creative tend to be more productive because they are always able to develop personal strategies of improving their productivity thereby enabling them produce large volumes of goods and services while workers who are less innovative and less creative, tend to be less productive of their less ability of getting better production ideas and they therefore end up producing few goods and services..
- **The political climate.** Political stability makes labour more productive because workers have fairly settled minds and can therefore produce greater quantities of goods and services while political instability/ insecurity leads to low productivity and efficiency of labour because the workers are always in fear which makes them produce few goods and services.

**Nb;**

**The same factors above determine labour efficiency however as one is explaining labour efficiency, she must talk about both quantity and quality since by definition, labour efficiency refers to the measure of both quantity and quality of output per the unit of labour in a given period of time.**

### **Exercise.( Do all the questions)**

Qn 1.Explain the factors that affect efficiency of labour.

#### **Answers**

**The political climate.**Political stability makes labour more efficient because it makes it have fairly settled minds and can therefore produce greater quantities of goods and services that are even of a good quality while political instability / insecurity leads to low labour efficiency because workers are under fear of losing their lives and property which makes them produce few goods that are usually of a poor quality.

***Give and explain the rest of the answers.***

2a) Distinguish between labour productivity and labour efficiency (4mks)

b) Explain the factors responsible for the low productivity in Uganda.

### **MOBILITY OF A FACTOR OF PRODUCTION**

Mobility of a factor of production refers to the degree of ease by which a factor of production can move from one geographical area to another or from one occupation to another. Therefore mobility involves a factor of production changing its occupation or work place.

#### **Mobility of labour**

This refers to the degree of ease with which labour can move from one occupation or geographical area to another.

Labour mobility is divided into twoie.

1. Geographical mobility
2. Occupational mobility

### **GEOGRAPHICAL MOBILITY OF LABOUR**

This refers to the degree of ease with whichlabour can move fromone geographical area to another.g. a nurse from Nsambya hospital moving to Masaka hospital but still as a nurse.

Causes of Geographical mobility of labour

- High wages in other geographical areas.
- High cost of living in the current place of work.
- Government policy of transferring civil workers.
- Better working conditions in other Geographical areas.

- Political instability at the current geographical area.
- Improvement in the transport and communication network in other geographical area.
- Light migration laws.

#### **Barriers to geographical mobility (causes of geographical immobility if labour)**

- High transport costs that are involved in travelling from one place to another thereby making labour decide to keep in the current place of work.
- High cost of living in the alternative places of work. This makes people fear to move to such areas.
- Socialites / family ties at the current geographical area i.e. many people don't want to leave their home areas especially when they have family members who require their support and attention.
- Strict national and international migration laws and requirements e.g. passports, visas, working permits etc. all of which make workers become reluctant to move to other geographical areas.
- Ignorance of labour about the existence of job opportunities in other geographical areas
- Political instability in the alternative places of work i.e. labour is reluctant to move to places of political instability because of fear of loss of lives and property.
- Poor housing facilities in the alternative places of work i.e. workers are reluctant to move to areas that are lacking decent accommodation.
- Old age i.e. old people develop body weaknesses that make them unable to move from one place to another.
- Law payments in the alternative geographical areas that make labour reluctant to move to such places.
- Permanent investments that one has put in one geographical area making him unable to move to other areas.
- Apathy among certain people i.e. some people feel uncomfortable to work in places with people who are not of their race, skin colour tribe, religion etc.
- Good working conditions in the current geographical area and therefore labour feels comfortable to stay in such places.

#### **OCCUPATIONAL MOBILITY OF LABOUR.**

This refers to the degree of ease with which labour can move from one occupation to another e.g. changing from being a cook to being a driver.

Occupational mobility of labour is divided into two forms ie..

1. Vertical mobility of labour
2. Horizontal mobility of labour

Vertical mobility of labour refers to the ease with which labour can change from one rank to another but still in the same occupation e.g. from being a class teacher to being a head teacher.

Horizontal mobility of labour on the other hand refers to the ease with which labour can move from one job to another while maintaining the same rank or status e.g. from a teacher in Nabisunsa Girls school to a teacher in Masaka S.S

#### **Causes of occupational mobility of labour.**

- Poor working conditions at the current job
- Better wages in other occupations
- Low prospects of promotion at the current job
- Job insecurity at the current Job
- Negative attitude towards the current job.
- Unhealthy competition amongst the workers at the current Job.
- Government policy of laying off workers.
- Lack of the required skills at the current job
- Low level s of specialization at the current job i.e. where labour is not trained to handle specific tasks, it gives labour high chances of transferring to other occupations.
- Low costs of training for the alternative jobs
- Short period of training for the alternative job.

#### **Factors limiting occupational mobility of labour / causes of occupational immobility.**

- Limited interests about the alternative jobs.
- Better wages in the current job
- Better working conditions in the current job.
- High discrimination in the labour market.
- Social ties / restrictions
- Limited natural ability.
- High costs of training for the alternative jobs.
- Low status of the alternative jobs (or high self esteem in the current job)
- Stringent requirements for the alternative occupation / bureaucracy
- Old age as some workers are too old to change jobs
- Barriers by trade unions and professional bodies.
- Long period of training requires for the alternative jobs.

#### **Factors determining occupational mobility.**

- The degree of specialization of labour in the current occupation or job. Labour that is trained to handle specific tasks becomes hard to adjust to new tasks and therefore highly specialized

labour is immobile occupationally while labour that is not specialized can easily adjust to new tasks hence high mobility.

- The period of training required for the new job. Where new jobs requires long periods of training, labour is discouraged to move to other new occupations as it gets afraid of spending much time in school hence low occupational mobility while where the period of training short, labour is encouraged to join training because it is easy and cheap and therefore immobility of labour is high.
- The prevailing working conditions in the alternative jobs. Where the working conditions in the alternative occupations are poor there is low mobility as they discourage the would be new entrants but where there are good working conditions, labour mobility is high as many labourers get encouraged to join.
- The costs of training for the alternative job i.e. high cost of training for the alternative job lead to low labor mobility because it is expensive to acquire the required new skills while low costs of training for the other job lead to high occupational mobility of labour.
- The level of wages in the other job i.e. high wages in the alternative occupation lead to high occupational mobility so as to get better remunerations while low wages in the alternative occupational led to low occupational mobility of labour as workers are discouraged from moving to such places.
- The knowledge about the existence of other job opportunities. Where labour is knowledgeable about the existence of other job opportunities, occupational mobility of labour is high as workers move to attain such jobs while limited knowledge about other job opportunities limits occupational labour mobility since labour can not move.
- The status / esteem attached to a particular job. where labour is satisfied and proud of the current job it is doing, there is low occupational mobility since it doesn't want to move to other occupations but where labour is unhappy and ashamed of the job, mobility of labour is high since one is not comfortable with the job they are doing..etc.

#### Factors influencing Geographical mobility of labour.

- Political climate in the alternative areas i.e. where the alternative areas are politically stable, labour mobility is high because labour is assured of safety of life and property. On the other hand, where the alternative areas are politically unstable, labour is discouraged to move to such areas leading to low geographical mobility of labour.
- Level of infrastructural development. High levels of infrastructural development lead to high degree of geographical mobility of labour because labour can easily move from one area to another and the reverse is true.
- The degree of attachment to social and cultural factors i.e. where there is strong attachment to cultural values (strong cultural ties) mobility of labour is low because of the strong attachments that labour has for example to family while weak attachments to cultural and social factors leads to high geographical mobility of labour as labour has no strong obligations to keep at the current work place.

- The health conditions of labour i.e. labour which is in good conditions is highly mobile compared to labour whose health conditions are poor since its energetic enough to move.
- The degree of restriction of international migration laws i.e. where the migration laws are strict (e.g. where its hard to get visas and working permits) geographical mobility of labour is low since it's hard to attain travel documents and vice-versa.

## **QN**

1 a) Distinguish between occupational mobility of labour and geographical mobility of labour.

- b) Explain the factors that determine the mobility of labour in your country.
- c) Explain the causes of
  - Geographical mobility of labour
  - Occupational mobility of labour.

## **ADVANTSGES OF MOBILITY OF LABOUR**

- Mobility of labour reduces the level of unemployment and under employment in some areas in the economy since labour can move from one area where jobs are scarce to where jobs are available.
- Mobility of labour promotes equal distribution of income in an economy because labour tends to change to higher incomes.
- Labour mobility helps to fill the manpower shortage in some areas / fields.
- It enables workers to acquire more skills because as labour changes from one job to another, it acquires new skills.
- Labour mobility improves on the international relationships between countries where workers move across boarders.

## **DISADVANTAGES**

- Labour mobility creates man power shortages especially in those occupations where low wages are paid to works.
- It may cause transitional unemployment due to changes in jobs and areas.
- It may lead to decrease in the level of output.
- It encourages brain drain with all its associated disadvantages.

N.B Brain drain refers to the movement of skilled labor from its own country to other countries in search of better paying jobs.



## **SPECIALISATION AND DIVISION OF LABOUR**

Specialization of labour refers to the process by which labour concentrates on the production of a given commodity where it can do better.

Specialization therefore refers to the process by which a country, region or individual concentrates on the production of a given commodity where a country / region / individual can perform best.

Division of labour on the other hand is where labour is divided into different minor tasks such that each individual does a particular task necessary to produce a complete commodity.

### **Types or forms of Specialization**

➤ **Specialization by commodity or by craft**

This is specialization which involves an individual or group of people concentrating on the production of a particular commodity and they can do best and then get the rest through exchange. It is the easiest form of specialization where families concentrate on the production of a particular craft and they can do best.

➤ **Specialization by process**

Here individuals or a group of people concentrate on the production of a particular component which they join together with other components produced by other individuals to produce a complete product.

➤ **Regional specialization**

This is where different regions of the country or the world concentrate on the production of particular products which are suitable for their natural resource endowment.

➤ **International specialization**

This is where a country concentrates on the production of the commodity in which it has the highest comparative advantage or in which they incur the least opportunity cost.

➤ **Specialization by profession**

This involves labour concentrating in producing work it is trained for example a medical doctor who concentrates in treating patients.

➤ **Specialization by sex**

This involves a particular sex (male or female) concentrating in joining a particular job e.g. there is a high concentration of the male sex in BodaBoda riding in Uganda.

### **Advantages of Specialization of labour.**

- It saves time because one remains in one place and on the single operation instead of moving from one place or operation to another.
- It improves the skills of the workers; this is because of the repetitions of a task which makes performance easy.

- It leads to increased production / output within a short period of time. This is because of the skills that the workers gain over time.
- It promotes international trade. This is because countries export what they produce and they import what they don't produce.
- It improves on the quality of the products. This is because of the use of machines as well as repetition of a given task on a daily basis which makes workers become more productive and produce high quality products.
- It improves on the efficiency of workers. This is due to high level of experience by workers.
- It improves on labour relations among the individuals. This is because of being inter-dependant where each worker or departments needs the values of each other.
- It promotes experiences amongst the workers. This arises due to the repetition of tasks on the daily basis.

### **Disadvantages**

- It leads to production of surplus output which may not be sold off in the market leading to wastage of resources as well as losses.
- It encourages dependency and interdependency among the workers i.e. the absence of one worker or breakdown in one of the sections affects the whole chain of production and brings work to a standstill.
- Leads to Monotony of work i.e. constant repetition of a task over again leads to boredom.
- It exposes workers to high risks of occupational hazards e.g. specialists in welding, spraying, painting etc. develop health complications if not protected.
- Unemployment is likely to occur in case of structural changes or use of machines.
- It reduces craftsmanship and creativity of workers. This is because machines do most of the work.
- Specialization and division of labour necessitates the use of machines in the long run which may be expensive.
- It may lead to quick depletion and exhaustion of resources because of greater experience that leads to higher productivity levels.

### **CAPITAL**

Capital refers to the man-made resources that facilitate the production process. It includes factory plants, machinery, equipment, money, human capital etc.

It should be noted that demand for capital is derived demand i.e. capital is not demanded for its own sake but for the sake of the commodities it helps to produce. The monetary reward to capital as a factor of production for its contribution in the production process is **interest**.

## **Types or forms of Capital**

### **1. Real / Physical capital**

This refers to capital in form of physical / tangible assets e.g. machines, buildings, furniture etc.

### **2. Social / Public capital**

There are assets that are owned by the entire society and people use them at no extra cost e.g. public roads street lights, etc

Or

It refers to capital that is owned by the state on behalf of the citizens e.g. roads, government hospitals, government schools, public Universities etc.

### **3. Private or individual capital**

This refers to the capital which is owned exclusively by an individual and yields income to user only e.g. a private car.

### **4. Money / liquid / nominal / financial capital**

This refers to capital in form of money

Or

This is capital in cash form mainly the bank notes and coins. This form of capital is used to purchase other forms of capital.

### **5. Human capital**

This refers to capital in form of knowledge acquisition.

### **6. Fixed capital**

This refers to capital in form of stationary or permanent assets e.g. factory plants. This capital is geographically immobile but can be occupationally mobile (can change jobs) e.g. buildings

### **7. Sunk capital**

This refers to the specialized capital which cannot easily be adopted in other productive alternative uses e.g. a concrete mixer cannot be adopted for other uses neither can a photocopier be used for typing.

### **8. Variable / circulating capital**

This refers to capital required for the day today activities of the firm, e.g. capital to buy fuel and raw materials.

### **9. Floating Capital**

This refers to capital that can be used for a number of purposes. This type of capital is non-specific.

## **SPECIFICITY OF CAPITAL**

This refers to the inability of capital to do other tasks.

Or

It refers to the difficulty of capital to be adopted in alternative uses.

Highly specialized capital can rarely change its location or occupation while less specific capital can always change its location and uses.

### **The relationship between specificity of capital and mobility of capital**

Very specific capital is basically immobile geographically while less specific capital is generally mobile occupationally and geographically.

## **CAPITAL ACCUMULATION AND CAPITAL FORMATION**

Capital accumulation refers to the process of increasing a country's existing stock of capital goods.

Capital formation refers to the process of creating a country's stock of capital (mainly through investments).

Capital is formed when people forego present consumption to increase on saving for investment.

This implies that to form or increase capital, we need to reduce on the present consumption through savings and invest the saved money by buying capital goods.

There are three aspects involved in capital formation

1. The volume of real savings
2. Mobilization of savings through financial system
3. Investment

## **FACTORS THAT DETERMINE / INFLUENCE THE LEVEL OF CAPITAL ACCUMULATION**

- **The level of income.** High income levels lead to high savings and investments which leads to a high level of capital formation while low levels of income lead to low savings and investments which lead to low capital formation.
- **The rate of inflation.** High levels of inflation discourage the process of saving because it makes the savers lose the real value of their savings which leads to low investment and hence low capital accumulation while low levels of inflation promote productive activities leading to higher incomes, high investment and high capital formation.
- **The level of Savings.** Individuals or institutions with high savings tend to invest produce more goods and services which lead to high capital formation while those with low savings invest less and thus less goods and services leading to low capital accumulation.
- **The investment climate.** A favorable investment climate characterized by tax holidays encourages people to invest which leads to high capital formation while the poor investment climate such as high taxes on the investors discourage investment which leads to low capital accumulation

- **Level of infrastructural development especially financial infrastructure.** A well developed financial sector promotes capital formation through its ability to promote savings which savings are used in investment leading to high capital accumulation while poorly developed financial infrastructure e.g. in form of poorly distributed commercial banks discourages savings which leads to low investment and low capital accumulation.
- **The level of entrepreneurship.** The existence of skilled and efficient entrepreneurs leads to efficiency in production leading to high output and high incomes thereby leading to high levels of capital accumulation while limited entrepreneurship leads to low investment and output hence low capital formation.
- **The market size.** A small market discourages investment which leads to low output and incomes of the producers hence low capital accumulation while a big market attracts both local and foreign investors leading to more output being produced which leads to increased income and high levels of capital accumulation.
- **The degree of accountability.** High degree of accountability characterized by low corruption and embezzlement of funds implies that most of the resources are properly invested in the planned productive activities which leads to higher income and higher capital accumulation while low degree of accountability in form of embezzlement of funds leads to low investment in the planned productive activities which leads to low capital formation.
- **The existing stock of capital.** Existence of a large stock of capital leads to the production of more goods and services for selling. This increases the income of the producer leading to more savings and high capital accumulation while existence of small stock of capital leads to small scale of output leading to low incomes of the producers and hence low capital accumulation.
- **The capital inflow and outflow.** High capital inflow e.g. through foreign investments increases the level of production hence leading to high capital accumulation while high levels of capital outflow (e.g. profit repatriation) implies that many resources are being carried out of the country which leads to low investment and low capital formation.
- **Political climate.** Political stability characterized by peace and good governance and freedom to work promotes entrepreneurship and investment in the country. Leading to high capital accumulation. This is because political stability assures investors and give them confidence in the country while political instability reduces confidence thereby discouraging investors from investing into the country thus causing low output and low capital accumulation.
- **The population growth rate.** A high population growth rate leads to high levels of dependence and consumption thereby reducing the ability of the income earners to save and invest leading to low capital accumulation while a low population growth rate encourages savings because of less consumption expenditure which leads to high investment and capital formation.
- **The state of technology.** Modern and efficient technology promotes production of more goods and services leading to high capital formation while poor techniques of production (low levels of technology) limit output of the firm since they are less efficient and thus leads to low capital formation.
- **Cultural factors / degree of conservation.** A high degree of conservation limits the production levels and investment levels since producers are less willing to adopt new production techniques leading to low capital accumulation while a low degree of conservation leads to

higher investments because of the willingness to adopt new production techniques hence leading to high capital accumulation.

- **The level of interest rates on loans.** High interest rate on loans discourage the borrowers since it becomes expensive for them to borrow hence leading to low investment and low capital accumulation while low interest rate on loans encourage the borrowers to borrow since it's cheap to attain financial credit hence leading to high investment and high capital formation.

QN

- Distinguish between capital accumulation and capital formation. (4 marks)
- Explain the factors that determine the level of capital accumulation in a country?

#### **FACTORS THAT LIMIT CAPITAL ACCUMULATION**

- **Political instability:** This reduces the confidence of the investors because of fear of losing their lives and property thus causing low output and low capital accumulation.
- **High levels of capital outflow:** This implies that many resources are being carried out to other countries which lead to low investment and low capital formation.
- **High population growth rate:** This leads to high levels of dependence reducing the ability of the earners to save and invest thus leading to low capital accumulation.
- **Low levels of technology / poor techniques of production:** The poor techniques of production limit the outputs of the firm and this leads to low capital accumulation.
- **High degree of conservatism:** This leads to low capital formation because people are so attached to their traditional production techniques that are associated with low productivity levels.
- **High interest rate on loans:** This discourages potential borrowers since it's expensive to borrow hence leading to low levels of investments and low capital formation.
- **Low levels of income:** The low levels of income lead to low savings and investments which lead to low capital formation.
- **High levels of inflation:** These discourage the process of saving because the savers lose the real value of their savings leading to low investments and low capital formation.
- **Low levels of accountability / high rate of corruption and embezzlement of funds.** This leads to low investment in the planned productive activities which leads to low capital formation.
- **The poor investment climate characterized by high levels of taxes and low levels of subsidization.** This discourages potential investor which limits investment leading to low levels of capital formation.

**Nb; Factors that affect capital accumulation and those that affect capital formation are the same.**

## Importance / roles of capital in the development process.

### Positive

- Capital increases the efficiency of other factors of production i.e. capital inform of machinery enableslabour to increase on the quality and quantity of its output.
- It enables technological transfer. Capital informs of money enables a country to buy new techniques of production from other countries in order to improve on the level of productivity.  
NB: technological transfer is the shifting of techniques of production from onecountry to another mainly from more developed countries to less developed countries.
- Capital promotes specialization. Different capital assets are designed to do specific jobs, this promotes specialization which increases productivity of firms leading to economic growth.
- Capital leads to the better use of resources i.e. capital inform of machines helps labour to use the existing resources more productivity e.g. the miners use different machines to extract raw materials and transform them to useful items.
- Capital facilities trade and exchange i.e.capitals inform of Vehicles is used to transport goods to markets for exchange.
- Capital simplifies and quickens production. Most machines are able to work at a higher pace and automatically. This easens work, increases output and saves time. E.g the ATM's in banks are able to serve many customers in a short period of time and they bring about convenience to the customers.
- Capital improves on the quality of the products produced. Most machines are designed to manipulate raw materials to make high quality finished products. These improve the quality of the products.
- Capital facilitates infrastructural development i.e. different types of capital areused to construct infrastructure i.e. the graders are used to construct roads and bridges while the cranes are used to lift loads while constructing buildings.
- Capital promotes industrialization in the countryi.e. capital assets are used when establishing industrial plans. These assets are installed in different production plants to increase the speed at which the goods are produced.
- Capital is used as collateral security to get loans. Real capital e.g. machinery, commercial buildings can be used as collateral security when securing bank loans. Such loans promote investment by enabling firms to establish new plants.
- Capital facilities research in production i.e. both real and money capital facilitate research in production and this enables production of improved quality products.
- Capital is an engine of economic growth and progress i.e it facilitates economic changes like modernization of Agriculture and industrialization. This can be both inform of money capital or real capital.

## **NEGATIVE**

- Capital leads to over exploitation of resources. This is because the machines increase the rate at which resources are being exploited. Some resources are therefore over exploited in the long run
- Capital creates social costs like pollution. Most machines pollute the environment by releasing toxic gases into the atmosphere. This reduces the quality of life of people in the affected areas.
- Capital causes technological unemployment i.e. machines replace human labour at places of work e.g. the ATM's have substituted human labour in banking leading to technological unemployment with its associated problems.
- It can lead to over production. This is because machines can produce goods and services at a high speed and at day and night.
- Capital investment of machines is associated with disastrous accidents. Such accidents lead to loss, of lives and property.
- Capital increases the costs of production i.e. most capital equipment is expensive to buy and also to maintain it in the good working state. This increases the costs of production leading to higher prices in the market.

## **Sources of Capital**

Some of the sources of capital in the businesses include;

1. Individual savings
2. Retaining the past profits as capital
3. Borrowing from financial institutions
4. Soliciting for foreign Aid
5. Sell of government securities such as treasury bills and bonds
6. Voluntary group saving schemes

1 a) Distinguish between capital appreciation and capital accumulation

b) Explain the determinants of the rate of capital accumulation in your country

2 Distinguish between capital formation and capital depreciation.

b) Account for the low levels of capital accumulation in your economy

c) Suggest measures that can be adopted to increase the rate of capital accumulation in your country

Capital depreciation refers to a decrease in the value of capital assets like due to the wear and tear during the production process.



## **Measures that can be used to increase capital accumulation**

**NB: these must increase the level of investment in the economy.**

- Increase in income
- Ensure political stability
- Development of the country's infrastructure
- Ensure political stability
- Control the population growth rate provision of credit / loans
- Development of entrepreneurship through training.
- Expansion of the market e.g. through encouraging economic integrations
- Land reforms.
- Provision of investment incentives such as tax holiday, tax rebates
- Encourage savings
- Improvement in technology through encouraging technological transfer and technological development
- Trade liberalization
- Privation of public enterprises
- Fight corruption.

***Leave space to explain this work.***

## **INTEREST**

Interest refers to the monetary reward for capital as a factor of production for its contribution in the production process.

Interest rate refers to the percentage/ proportion of the values of borrowed money that the borrower has to pay back in addition to paying back the principle sum borrowed in a given period of time

### **DETERMINANTS OF THE RATE OF INTEREST**

- The supply of the loanable funds.
- The period of the loan repayment.
- The level of risks involved in investment.
- Objectives of the lender.
- The rate of inflation in economy.
- The demand for loanable funds.
- The economic situation of the country i.e. in an economic depression.
- The money supply.

## MARGINAL EFFICIENCY OF CAPITAL

Marginal efficiency of capital refers to the anticipated monetary returns from additional unit of capital employed.

### DETERMINANTS OF M.E.O.C

- Availability and efficiency of co-operant factors. A high level of efficiency and presence of enough co-operant factors for capital leads to high marginal efficiency of capital while a low level of efficiency and inadequate co-operant factors for capital leads to low marginal efficiency of capital.
- The anticipated output of capital. High anticipated output leads to high marginal efficiency of capital while low anticipated output leads to low marginal efficiency of capital.
- The size of the market. A large market size leads to high marginal efficiency of capital while a small market leads to a low marginal efficiency of capital.
- The rate of depreciation of capital. A high rate of capital depreciation leads to low marginal efficiency of capital while a low rate of capital depreciation leads to high marginal efficiency of capital.
- The price level in an economy. A high price level in an economy leads to a high marginal efficiency of capital while a low price in an economy leads to a low marginal efficiency of capital.
- Availability of excess capacity. Lack of excess capacity leads to low marginal efficiency of capital while existence of excess capacity leads to high marginal efficiency of capital.
- Availability of excess capacity. Lack of excess capacity leads to low marginal efficiency of capital while existence of excess capacity leads to high marginal efficiency of capital.

## ENTREPRENEURSHIP

This refers to a factor of production which initiates production, raises initial capital, mobilizes other actors of production and decides what to produce.

It is a factor of production that helps to combine and supervise other factors of production to produce goods and services. It is mainly engaged in the management and administration of the business.

An entrepreneur is a person who initiates business activities and undertakes risks involved in the business. The monetary reward for entrepreneurship is **profits**.

## **FUNCTIONS OF AN ENTREPRENEUR**

- Initiating business activities i.e. the entrepreneur is an inventor of the business concerns for he thinks about what to produce and initiates production.
- Mobilizing other factors i.e. he mobilizes labour, capital and land therefore he makes an arrangement to reward the hired factors of production
- Making decisions. The entrepreneur takes high levels of decision making concerning the running of the business i.e. regarding what to produce, how to produce and when to produce.
- Coordinating the business activities. He is responsible for the general monitoring, supervision and co-ordination of business undertakings.
- Making all necessary innovations and changes for the good running of the business.
- Bearing of business risks. The entrepreneur risks his capital and other resources against uncertainties in the business. This is his main function.
- He manages profits and losses of the firm. The entrepreneur enjoys all the profits alone and also the losses.

## **FACTOR DETERMINING THE SUPPLY OF ENTREPRENEURSHIP IN AN ECONOMY**

- The level of education and training especially training
- The government policy in relation to investment e.g. regarding taxation incentives.
- The level of natural abilities / special talent in management / level of natural creativity and innovation.
- The level of infrastructural development
- The size of the market for goods and services.
- The social-economic factors such as traditions and culture religion etc.
- The political climate.
- Availability of capital and other co-operant factors.

### **QN:**

1. Mention any four factors influencing the supply of entrepreneurship in an economy.
2. What are the functions of an entrepreneurship in an economy.

## **THE CONCEPT OF PROFITS**

Profit is the monetary reward to entrepreneurship as a factor of production. Unlike other factors prices, profit is a unique factor reward because of the following:

- Profits can be negative or zero yet other rewards are always positive
- Profits is residual i.e. it is earned after other factor payments are made.
- Profit is uncertain and unstable i.e. it fluctuates / changes from time to time
- Profits are never contractual yet other rewards are contractual. This is because it cannot be mentioned or stated at the beginning of the production process.

## TYPES OF PROFITS

➤ Normal profits / Zero profits

This refers to the reward to an entrepreneur / a firm that is just enough to cover the total costs or keep him / it in production without inducing other firms to join the industry.

NB: Normal profits are made when total cost = Total revenue

➤ Supernormal / abnormal profits

This refers to the reward to an entrepreneur over and above the normal profits / total costs and it induces other firms to join the industry.

➤ Subnormal Profits / losses

These are profits where average cost is greater than average revenue.

➤ Economic profits

These are earnings that are derived by getting the difference between revenue got by a given firm from the sale of its output and the opportunity cost of the inputs used in the production of the output.

Or

Economic profits refer to the difference between the revenue got by a firm and what it would have got in the second best alternative use.

## DETERMINANTS OF THE SIZE OF THE PROFITS

➤ **The price level in the economy.** High price levels of goods and services result into high profit levels because at high prices goods are brought expensively while at low prices, low profits are got because goods are bought cheaply.

➤ **The costs of production.** High costs of production lead to low profits because with high costs of production, it implies that it is expensive for the producer to carry out production while low costs of production lead to high profits because for the producer to carry out production.

➤ **The objective of the producer / the goal of the producer.** A producer who is aiming at maximizing profits is likely to make more profits than the producer who aims at welfare maximization and this is because he charges a higher price..

➤ **The size of the market.** A large market size of the product of the firm leads to high prices thus leading to high level of profits while a small market leads to low profits because the prices are low.

➤ **The number of firms in the industry / the ease of new firms into the industry.** A large number of firms that are involved in production leads to high levels of output leading to low prices hence low profits while a small number of firms in the industry leads to the low level of output leading to high prices hence high profits in the firm.

➤ **The level of output produced by a firm.** A high level of output produced by the firm leads to low profits because of the low prices while a low level of output produced by the firm leads to high level of profits because of the low prices.

- **The level / degree of risks involved in the business.** A high level of risks involved in the business results into high profits because few producers are willing to undertake such risks while low level of risks involved in the business discourages producers to join the competition hence low profits.

### **ROLES OR IMPORTANCES OF PROFITS IN AN ECONOMY**

- Profits are used for the expansion of the size of the firm i.e. Profits are ploughed back or re-invested back into the business to expand the size of the firm.
- Profits induce / attract other new firms to join the industry which leads to an increase in the level of investment as well as the level of output of goods and services.
- Profits made by the firm are taxed by the government to raise government revenue which is used for financing its different expenditures.
- Profits are used by the firm to determine the level of output i.e. to make decisions on whether to increase or to decrease the level of output e.g. if it is realized that profits are reducing as the firm increases its output then it is benefiting for the firm to reduce its output.
- Profits are a measure of the degree of risks in investment because high profits are usually associated with the high level of risks in the investment.
- Profit levels guide the government in formation of taxation policies in that firms that earn high levels of profits are taxed more than firms that make low profits.
- Profits induce entrepreneurship to undertake risks in investment since they are the rewards to the entrepreneurship i.e. they encourage to accept the uncertainties in business and make them risk their capital in order to earn the high profits.
- Abnormal profits are an incentive to production i.e. profits encourage producers to produce goods and services because they can be re-invested in the production process.
- Profits indicate whether the firm is growing or declining. Super normal profits indicate that the business is growing while subnormal profits indicate that the business is declining.
- Profits determine the resource allocation i.e. more resources are allocated in those industries where more profits are made.
- Profits stimulate inventions and innovations which increase production and efficiency.

### **BUSINESS ORGANISATIONS / ENTREPRISES.**

A business enterprise refers to any organisation by one or more people who contribute capital in order to carry out production of goods and services with an aim of making profits.

A business enterprise / unit may be owned privately or may be state owned or jointly owned by private individuals and the government.

## **TYPES OF BUSINESS ORGANISATIONS.**

They are 5 which include

1. Sole proprietorship
2. Partnership
3. Co-operative societies
4. Joint stock companies
5. Parastatal organisation / public enterprises.

### **SOLE PROPRIETORSHIP**

This is a form of business enterprise whose control and management is under one person. He is the only decision maker of the firm he undertakes all the risks involved and enjoys all the profits alone. This is very common in retail trade.

#### **Advantages.**

- He enjoys all the profits alone. There is easy and quick decision making since the owner has full control of the business and there is no bureaucracy.
- There are no complicated procedures that are required to start up business.
- There is a lot of flexibility in business under sole proprietorship as the owner of the business can easily make changes within a small / short period of time.
- A sole proprietor is able to maintain a special relationship with his or her clients therefore he can give personal attention to his customers.
- The owner is encouraged to work hard since he doesn't share profits with anybody else.
- There is secrecy of high order in the running of the business this is because the business secrets are kept by only one person.
- In case of death of the owner, inheritance is more easily done than in partnership.

#### **DEMERITS / DISADVANTAGES.**

- A sole proprietor suffers all the risks and losses alone
- There is limited continuity of the business in case of death of the owner.
- The owner of the business may over work himself as he is trying to expand his business. This is because he does everything alone.
- There is unlimited liability i.e. in case of the collapse of the business, the owner is fully responsible for all the debts of the business and therefore it may involve the selloff of his personal property.

## **PARTNERSHIP**

Partnership refers to a business Organisation that is formed by a group of individuals whose membership ranges between 2 – 20 who contribute capital with an aim of making profits.

NB:

The minimum number of partners is 2 and the maximum is 20. Partnership begins operation when the partners have signed a partnership deed.

### **TYPES OF PARTNERSHIP**

1. Ordinary partnership / unlimited partnership  
This is the type of partnership where members have unlimited liability i.e. each member of the partnership is full liable for the losses and debts incurred by the firm.
2. Limited partnership.  
This is one where members have limited liability i.e. in case of losses, and debts each member can only lose the capital he or she contributed but does not lose his personal property.

### **TYPES OF PARTNERS**

1. ACTIVE PARTNERS  
These are partners / members who are directly involved in the day to day running of the business on top of contributing capital to start up the business.
2. DORMANT PARTNERS  
They are partners who contribute capital to start up the business but don't participate in the day to day running of the business.
3. QUASI PARTNERS  
These are partners who do not contribute capital and are not allowed in the day to day running of the business but allow their names to be used by the business because they are prominent.

### **Advantages of a partnership**

- More capital is contributed compared to a sole proprietorship
- There is continuity of the business in cases of the partners on in cases of absence or sickness of one partner
- The accessibility of loans from financial institutions is more easier compared to sole proprietorship because financial institutions find it easier to trust many partners than a single partner.
- Specialization and division of labour is possible in the business because different partners are talented differently.
- The business benefits the variety of skills that are produced by the different members.

### **Disadvantages**

- There is delay in decision making since consultations have to be made i.e. there is bureaucracy
- There is unlimited liability particularly under ordinary partnership where even private property can be encroached on to clear the losses and debts
- Profits have to be shared amongst the members which reduces each member's share
- Disagreements between partners may affect the operation of the business and it may collapse.
- In case of death or resignation of the key partner, the business may collapse.
- Sometimes it results into laziness / incompetence / inefficiency among the members as each one of them tries to escape from the irresponsibility's after all the profits and losses are shared amongst the members.

### **LIMITED LIABILITY COMPANIES / JOINT STOCK COMPANIES**

These are businesses organizations or units whose membership ranges between 2 to infinity members for private limited companies or 7 to infinity for public limited companies who contribute capital through buying shares from the firm with an aim of making profits.

The members who contribute capital through buying shares are called shareholders.

NB

- A shareholder refers to a unit of capital in a joint stock company
- A debenture is a unit of a loan that is extended to the business.
- Characteristics of public limited company
- It has a minimum of 7 members with no maximum membership.
- Shares are freely transferrable from one share holder to another.
- The company is a legal entity.
- The members have got limited liability.

### **Advantages of public limited companies**

- Members have got limited liability
- More capital can be contributed through the buying of shares
- Specialization is possible on the firm.
- Shares are freely transferable from one person to another.
- The company operations are not affected by death / absence / bankruptcy of any member for the company.

### **Disadvantages**



- Shareholders don't have direct control over the running of the business.
- Decision making is quite slow i.e. there is bureaucracy
- Some public limited companies become too large to attain maximum efficiency
- The procedure of the public limited which is quite long as it has to obtain several documents such as prospectus, memorandum of association etc.

## **PRIVATE LIMITED COMPANY**

This refers to a business organisation comprising of a minimum of two members and no maximum who contribute profits through buying shares of the company with an aim of making profits. They are usually in size and commonly a group of friends or family members.

### **CHARACTERISTICS**

The membership is between two to infinity

The shares are not freely transferable from one person to another i.e. members are not allowed to sell their shares publically

They are not allowed to publicize their accounts to the public.

NB

The advantages of private limited liability company are the same as those of public limited company. However we add on one advantage that a private company enjoys a lot of Independence and that the owners can keep their secrets.

## **CO-OPERATIVE SOCIETIES**

A cooperative society is a voluntary association made up of people who have got a common and active interest in performing a business purposely to benefit the members.

### **TYPES OF COOPERATIVE SOCIETIES**

The producer's cooperative society

The consumer's cooperative society

The transport cooperative society

The savings cooperative society.

## **PRINCIPAL OF COOPERATIVE SOCIETIES**

Open and voluntary membership i.e. anybody is free to join the cooperative society

There is democratic administration.

Sharing of profits is done according to each member's contribution to the activities of the cooperative society.

Cooperation with other cooperative societies.

### **ROLES OF COOPERATIVE SOCIETIES**

They provide credit to the members which credit can be used for various development purposes.

Cooperative societies provide storage facilities for both raw material and finished products they educate / train producers on how to use or apply modern techniques of production

They help in the transformation of the economy from the subsistence economy to a monetized economy.

### **PROBLEMS FACED BY C.S**

Financial problems i.e. limited funds which are sometimes mismanaged

They are faced by poor management characterized by embezzlement of funds.

### **PRODUCTION PERIOD**

1. The very short run monetary period

This is a production period where all the F.O.P are fixed and the firm can only move by withdrawing some of its output that was kept in the store.

2. Short run of production period

This is a production period which is too short to change a fixed factor into a variable factor  
OR

It is a production period when a firm is able to utilize more of the valuable F.O.P while the fixed factors of production remain constant in order to increase in the level of output.

In other words, in the short run, some of the F.O.P must be fixed.

3. The very long run production period

This refers to the production period when the firm is able to employ better technology in the production in addition to employing more of both fixed and variable better technology in production in addition to employing more of both fixed and variable F.O.P when increasing output i.e. it is a production period in which the firm is able to change its production techniques in order to increase its level of output.

### **THE THEORY OF A FIRM**

A firm refers to a unit of production under unified control and management that is engaged in production of goods and services to satisfy human wants e.g. century bottling company, Crown beverages, vision group companies, Nile breweries etc.

An industry refers to a group of firms that are producing similar or related goods using similar inputs e.g. the beer industry which involves firms like Nile breweries, Uganda breweries, the soft industry which includes Century bottling company crown beverages etc.

Objectives of the firm

To maximize sales

To maximize profits

To provide employment opportunities especially to family members

To provide essential goods and services at affordable prices.

### **DECISIONS OF THE FIRM**

A firm has to take decisions concerning

How to produce

When to produce

How much to produce

For whom to produce

### **LOCATION AND LOCALIZATION OF FIRMS / INDUSTRIES.**

Location refers to the area or place where a firm or an industry is established.

OR

It is the setting up of a firm or an industry in an area irrespective of whether there are other firms / industries in that area or not since the major aim of firms is to maximize profits, firms try to locate their establishment at the lowest cost location.

### **FACTORS INFLUENCING LOCATION OF A FIRM OR AN INDUSTRY.**

#### **Availability of raw materials**

Firms tend to be established near the sources of raw materials especially where the raw materials are very bulky therefore easily to transport. Such industries that must be established near their sources of

raw materials are referred to as rooted industries. Foot loose industries on the other hand are those industries that can be located anywhere because the raw materials are light and easy to carry.

### **The size of the market**

Firms tend to be located in areas where there is adequate market for their products. This is especially positive for those firms whose products are highly perishable or fragile but these other firms that produce goods that are neither perishable nor fragile can be located in areas that are far from the market.

### **Availability of power supply**

Firms that use machinery and equipment heavy machinery and equipment have to be located in areas where there is enough power and energy while those that don't need much power and energy can be widely spread or be located.

### **Availability of labour**

Industries that use labour intensive technology are usually located in areas where there is cheap labour force. This is why such industries or firms are located in densely populated areas of Kampala and Jinja where labour is abundant and cheap.

The government policy regarding the location of industries i.e. sometimes the government gazettes areas in the country where particular industries must be established or located. Most LDC's government attach a great importance on the development of rural areas and the fair distribution of industries in the country.

### **Availability of land or space Land provides a site on which industries / firm are located.**

Firms therefore tend to be located in areas where there is enough land and at a cheaper cost which land can be used for expansion for instance firms that are involved in agriculture.

### **Availability of transport and communication**

Firms or industries tend to be located in areas where there well developed transport and communication network for easy transportation of raw materials and finished products.

### **The political climate**

Most industries are located in areas which are politically stable while those areas of the country that are politically unstable don't attract serious industrial investors even if there are favorable factors.

### **The degree of the entrepreneur**

Some entrepreneurs locate their firms or businesses in particular areas of the country because of reasons best known by them.

**Availability of auxiliary / supporting services.**

Many industries are located near banking institutions, hospitals, warehousing, insurance etc. these auxiliary services attract industrial activities and therefore they facilitate industrial growth e.g. banks offer credit facilities to industrialists.

**Availability of water**

This is to firms that use water. Water is important for industrial development because it cools the machines; it is used as transport means and a medium through which industrial wastes are disposed off. For the reason water must be at a low cost.

**Industrial inertia**

This refers to the tendency of industries to continue location / continue surviving in an area where other industries exist even when the factors that led to the location of their industries no longer apply. Some firms tend to be located in areas where other firms don't exist.

**LOCALISATION OF AN INDUSTRY**

This refers to the concentration of an industry in a given area or given region

OR

It refers to the concentration of many firms producing similar or related products in an area.

The concentration always involves major industries and subsidiary industries. Localization maybe as a result of presence of raw materials in a given area availability of market for the products of the industry, government decision to locate the industry in a particular area etc.

**ADVANTAGES OF LOCALIZATION**

It leads to the development of infrastructure in the area i.e. transport and communication network, power and energy projects etc are likely to be developed in the area in order to facilitate production by the localized industries.

Creation of employment opportunities in the area i.e. people in the area where the industry is located get jobs in the industries and earn incomes which improves their standards of living.

It results into cooperation between the industries or firms in the area in solving common problems such as security problems and other problems regarding facilities in the area.

It leads to the development of a pool of skilled labour in the area which labour can be utilized by new firms established in the area.

It leads to a wide variety of goods produced in the area because of the competition in the localized areas, the industries in the area venture into production of different varieties of goods.

It leads to increased utilization of the would be idle resources since the localized firms have to use them as inputs.

Encourages forward and backward linkages in the area i.e. firms / industries in the area provide inputs for other industries in the area while others provide market for the product of the other industries in the area.

It leads to increased output and economic growth due to the many firms that carry out production in the localized area.

Popularity of the area. The place where the industry is localized and so do the products that are manufactured in that area. More investors are attracted to set up industrial firms leading to production of more goods and services in that area.

It promotes specialization and its associated advantages as the firms concentrate on particular activities.

It leads to an increase in the quality of the output produced because of the competition in the localized area.

It leads to the development of auxiliary services in the area such as banking, insurance, warehousing, clearing and forwarding etc.

#### DEMERITS

It leads to imbalance in regional development in those areas where the industries are localized tend to develop a head of other areas in that country.

It results into rural-urban migration with all its associated negative effects such as development of slums, high crime rate, etc. This is because people tend to move to areas where the industries are localized to get employment opportunities as well as benefiting from better facilities.

It leads to over straining of the infrastructure in the areas social facilities like housing, health centres, power and water are over strained due to the increasing population in that localized area. This increases government expenditures as the government tries to provide social services to other people.

It worsens the problem of income inequality. This is because of the fact that people in the localized area get high incomes out of employment in such industries compared to their counterparts in other areas.

Leads to over exploitation and depletion of resources in the area because of the various firms or industries that utilize resources as their inputs.

Leads to environmental degradation in the area e.g. through pollution of water bodies and the atmosphere in the localized area by the industries.

It leads to increase in the costs of production such as labour costs i.e. labour costs become high because of the high demand for labour arising from the firms in the localized area.

It leads to displacement of people as more land is taken up for industrial development. Many industrial investors are forced to encroach on land for residential purposes in order to establish their industries. This results into displacement of people to other areas where they can settle.

It results into an increasing cost of living in the area because prices due to the increasing odd in the area.

## **DELOCALIZATION**

This refers to the government act of spreading industries country wide. It is a policy as deconcentration of industries in different areas of the country.

Or

Delocalization of firms / industries refers to the deliberate government policy of evenly distributing firms / industries in different areas of the country. It is deliberately undertaken by the government in order to reduce the problems associated of delocalization of industries.

## **REASONS FOR DELOCALIZATION**

To create employment to different parts of the country

To reduce rural-urban migration and its negative consequences

To reduce imbalances in regional development

To minimize the social effects such as pollution in particular areas of he country.

To facilitate development of infrastructure in different parts of the country

To transform the economy from the subsistence economy to a commercial economy.

### **NB**

Backward linkage is where the existence of an industry leads to the settling of a new industry to supply it with raw materials while forward linkage is where the settling of an industry results into settling up a new industry which new industry sets up the market for the existing industry.

### **THE PRODUCTION FUNCTION**

A production function refers to the statement showing the relationship between output produced by the firm and the amount of input used in production i.e.

$$Q = f(L, K, N, E)$$

Where

Q – Output produced

L – Labour

K – Capital

N – Land

E – Entrepreneurship

An example of simple production relating output with the labour input using production can be

$$Q = 20 + 4L$$

By use of such a production function, you can find out the number of labourers / workers needed to produce a given level of output e.g.

Calculate the number of workers that are needed to produce 60 bags of rice using the above production

$$Q = 20 + 4L$$

$$60 = 20 + 4L$$

$$4L = 60 - 20$$

$$L = 10 \text{ workers}$$



We can alternatively find the level of output produced by the firm given the number of workers.

## OUTPUT OF THE FIRM

This refers to the amount of goods and services that is produced by a firm after using / employing factor inputs. Sometimes it's referred to as product.

A firm output can be categorized as

1. Total product
2. Average product
3. Marginal product

### Total product

This refers to the total output produced by a firm using all the factor inputs employed by the firm in given period of time.

### Average product

This refers to the total output / total output per unit of the variable factor employed by the firm i.e. as

$$A.P = \frac{\text{Total product}}{\text{No of units of a variable factor employed}}$$

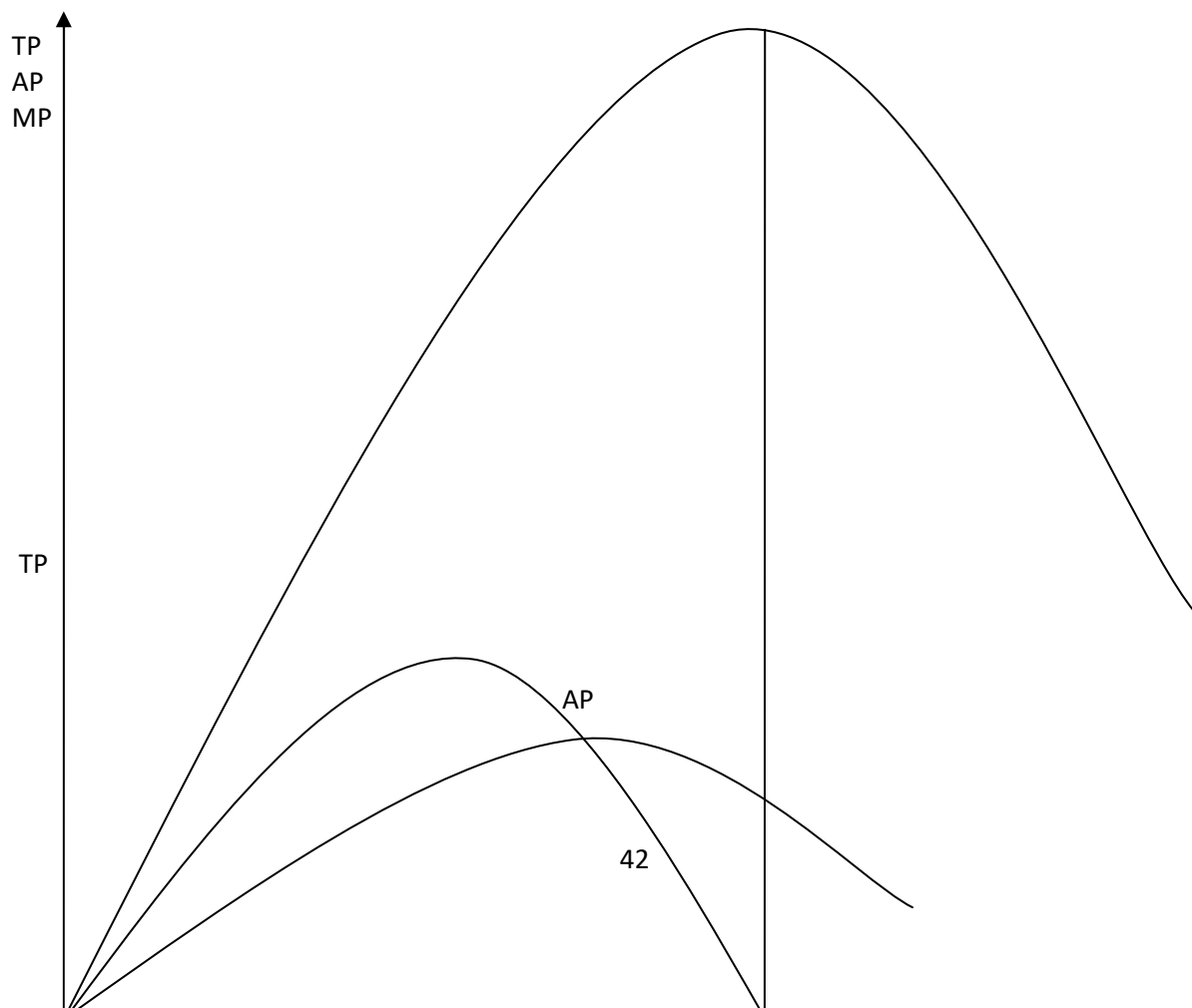
### Marginal product

This refers to the additional output of the firm that results from employment of an extra unit of variable factor i.e.

$$MP = \frac{\Delta TP}{\Delta \text{No of units of a variable factor employed.}}$$

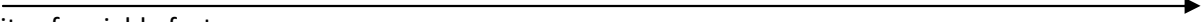
Land	Labour	T.P	AP	MP
10	0	—	—	—
10	1	5	5	5
10	2	15	7.5	10
10	3	45	15	30
10	4	73	18.3	28
10	5	86	17.2	13
10	6	91	15.2	5
10	7	91	13	0
10	8	87	10.9	- 4

From the table above, it can be retired that as successive units of available factor 9eg. Land) arte applied onto a fixed factor (e.g.land), total product, merge product and marginal product begin by increasing, up to a maximum than they star decreasing. However, each one of them reaches its maximum at different points as illustrated below.



MP

0 Units of variable factors



Initially successive units of a variable factor are applied to a fixed factor the marginal product begins by increasing and by increasing and at such a point where the marginal product is increasing, the fixed factor is not fully utilized indicating / implying that more and more variable factors should be employed.

At the point when the MP is at maximum, the fixed factor is fully utilized and therefore variable factors should be applied to the fixed factor. However if more units of a variable factor are applied, marginal product decreases. This is because of the law of diminishing returns or the law of variable proportions.

#### **RELATIONSHIP BETWEEN TOTAL PRODUCT AND MARGINAL PRODUCT**

When T.P is increasing, MP is also increasing. When T.P is at its maximum / highest M.P is zero (0). When T.P is decreasing, M.P is negative.

#### **RELATIONSHIP BETWEEN M.P AND A.P**

When A.P is increasing, M.P is greater than A.P

When A.P is at maximum, M.P is less than A.P

#### **THE LAW OF VARIABLE PROPORTIONS**

It states that as more and more units of variable factor are applied to a fixed factor in a given state of technology, marginal product of the variable factor increases up to a maximum and then declines

#### **THE LAW OF DIMINISHING RETURNS**

It states as more and more successive units of a variable factor are applied onto a fixed factor in a given state of technology, there will come a time when marginal product of a variable factor will eventually diminish / decline. ; This law is illustrated by the whole range of the marginal product curve

Assumptions of the variable proportions / the law of diminishing returns

It assumes a short run production period

There should be a fixed factor

There must be a variable factor

The technology should be constant and not improved on

It assumes that all units of the variable factor are homogenous and equally efficient

It assumes that output is measurable in quantifiable units

It assumes that it is possible to vary proportions in which the fixed factor and the variable factor are combined.

## **RETURNS TO SCALE**

This refers to the relationship between a given change in the scale of inputs and the resulting change in the level of output in the long run where all inputs varied in the same proportions. Therefore returns to scale involves the rate at which output changes factor combinations are changed.

There are three forms to scale which include

### **Increasing returns to scale**

This is whereby a given percentage increase in the level of inputs produced leads to a bigger percentage increase in the level of output produced e.g. when inputs are doubled and the outputs more than doubles.

### **Constant returns to scale**

This is where by a given percentage increase in the level of inputs produced leads to an equal percentage increase in the level of output produced e.g. when inputs are doubled and outputs are doubles.

### **Decreasing returns to scale**

This is where a given percentage increase in inputs leads to a smaller percentage increase in the level of outputs produced e.g. when inputs are doubled, outputs less than doubles.

## **THE SIZE AND GROWTH OF A FIRM**

The size of the firm is indicated by the following.

The level of output produced by the firm.

The level of inputs used by the firm e.g. raw materials

The size of the market for the firm products

Generally, a large firm produces more output, employs more inputs and serves a bigger market as compared to the smaller firms

Firms can grow in size in two major ways

- a) Natural internal growth
- b) Merging Artificial internal growth

### **Natural / internal growth**

This refers to the growth or expansion in the size of the firm due to internal factors e.g. ploughing back profits, better management borrowing money to expand the level of output.

Or

This is where a firm's growth is through re-investing the profits it makes

Merging / amalgamation (artificial growth)

Merging / integration of firms is where two or more firms join to become one large firm in order to enjoy large economies of scale.

A merger is a combination of two or more firms

Merging may also involve two or more firms producing similar or related products

### **FORMS OF INTEGRATION / MERGERS**

#### **1. HORIZONTAL MERGING**

This is the union or combination of two or more firms in the same industry and at the same level or stage of production

#### **2. VERTICAL MERGING**

This is the union of two or more firms in industry but at different stages of production and combine into one production unit e.g. a tea growing firm with a tea processing firm

#### **Vertical merging is of two major types**

- a) Backward vertical merging

This refers to merging towards the source of raw materials e.g. a tea processing firm taking over a tea estate firm.

- b) Forward vertical merging

This is merging towards market for the firms products.

c) Conglomerate merging

This is where two firms are producing totally different commodities join n to make up a firm.

Or

This involves two or more firms producing completely different and unrelated commodities combining e.g. a firm making hoes with one making shoes.

### **3. LATERAL MERGING**

This involves different firms producing different but related products merging

### **FACTORS THAT DETERMINE THE GROWTH AND SIZE OF A FIRM**

**NB**

There are given points like size, degree, level of, amount of, nature of etc and we give two sided explanations

#### **Size of the market**

Firms with a large market are encouraged to produce large output in order to satisfy their buyers and they earn highly leading to high output thus growth in size while firms in small markets produce little output and have limited growth.

#### **Availability of land for expansion**

Firms with large pieces of land are able to grow very fast because they use existing and to increase the level of production and output as compared to those firms with limited land as it sometime becomes hard for them to expand.

#### **The size of the existing capital stock**

Firms with large sums of capital are able to use this capital to produce larger output and make large sells, this enables them to grow very fast in size while those firms with limited capital produce little output, make little or no profits hence leading to low growth

#### **The level of technology**

Firms using modern technology are able to produce high output for the market and this increases their markets shares and revenue thus enables them to grow very fast while firms with poor technology produce little output and get little income which limits their growth.

#### **The nature of the goods and services produced.**

Firms producing durable items are in position to produce large output because such output can easily be stored and brought on market whenever demand increase which enables firms to grow fast while firms producing perishable items have limited growth because they produce little output.

#### **Availability of Raw materials**

Firms with adequate and reliable sources of raw materials are able to produce regularly and this stabilizes their incomes. This in turn enables them to grow faster while those firms' with unreliable sources of inputs are unable to produce regularly which limits their growth.

#### **The level of entrepreneurship**

Firms with highly trained and skilled entrepreneurs register high growth because such people are able to mobilize and supervise other F.O.P for increased o/p while limited entrepreneurship limits growth

#### **Availability of skilled labour**

Firms with a large no. of skilled workers grow very fast because they use such workers to produce high quality which brings a lot of income and vice versa.

#### **The political climate**

Firms that exist in politically stable areas easily grow because production goes on smoothly which increases o/p while firms that are located in politically unstable areas don't, grow fast because their production activities are disrupted leading to low o/p and limited growth.

#### **The existing economic atmosphere e.g. the rate of inflation**

Economic stability in form of low levels of inflation create a favorable environment for investment by the different firms and this enables firms to grow fast while economic instabilities like high rates of inflation scare firms from further investment which limits their growth.

#### **The government policy on taxes and subsidies**

A favorable government policy on taxes and subsidies enables the firms to grow very fast e.g. a reduction on corporate taxes on the company's profits enables the firm to retain a big percentage of profits made for reinvestment while an increase in the level of taxation and a reduction by the government increases the costs of production hence reducing the firm's ability to grow.

#### **The level of infrastructural development**

Presence of well developed infrastructure e.g. power and energy results into easy production because of the stable power supply which results into high output which enables firms to grow fast while poor infrastructure such as inadequate power leads to low production hence limiting the growth of the firms.

### **Objective of the owner of the firm**

Where the aim of the firm is to produce high output and maximize sales makes it easy for the firm to expand and grow but where the goal is to maximize profits, which makes it difficult for the firm to grow.

### **Causes of differences in the size of the firms.**

Differences in the level of technology

Difference in capital stock

Difference in the objectives of owners of firms

Differences in the nature of goods and services produced

Difference in the level of entrepreneurship and management

Differences in the level of supply of raw materials

Difference in the government policy of taxation

Difference in the level of supply of skilled labour

Difference in the size of existing land for expansion

Difference in the state and nature of the available infrastructure

Difference in political climate

### **ADVANTAGES OF MERGING / INTEGRATION OF FIRMS**

Merging results into lower costs of production per unit of output (lower average cost). This results from the enjoyment of the importance of scale and profits of high level of output.

It leads to production of better quality products.

This is because as firms combine to become bigger, it becomes possible to output better techniques of production and to carry out research which leads to an improvement in the quality of profits.

It leads to an increase in the level of efficiency within the firm. This is because it becomes possible for the firm in addition to research and employment of better technology.

Many results into high level of output produced which results into production of larger scale



It reduces duplication and wastage of resources i.e. one firm can efficiently produce the quantity of a commodity needed instead of the commodity being produced by many firms

Integration of firms reduces competition for market for the product. This is because there are other firms that produce the commodity.

Merging of firms leads to an increase in the level of exploitation of the country's resources. This comes as a result of large scale production or high levels of output produced.

It leads to a reduction in the competition for the Raw materials used in production. This is due to a reduction in the number of firms that utilize the raw materials.

It leads to a reduction in the advertisement costs.

This is due to a reduction in competition which reduces the need for advertising.

It leads to an increase in the government revenue in form of taxation due to the fact that more output is produced in which output is taxed by the government.

Merging facilitates sharing of risks and losses by the firm. i.e. a loss making firm can continue to survive if it merges with a profit making firm.

Merging increases the firm's access to financial assistance or loans from financial institutions. This is because it has more assets that can act as collateral security for borrowing from financial institutions.

It results into higher levels of profits for the firm due to the high level of output produced and the lower costs per unit of output produced.

It leads to an expansion in the size of the market for the firm's output. This is due to the reduction in the no. of firms competing for the available market.

## **DISADVANTAGES**

Results into a monopoly situation i.e. when the firms merge, they become one firm which dominates the market which may lead to exploitation of the consumers.

It results into high taxation by the government on the output produced and profits made by the firm.

It results into diseconomies of scale which comes as a result of over expansion of the firm

It results into overproduction and wastage especially where the market for the product is small

It leads to over exploitation of resources where the market for the product is small.

It leads to over exploitation of resources in a country which comes as a result of large scale production.

It leads to loss of direct contact of customers due to large scale production.

It leads to unemployment. This is because of the employees of the firms that have to increase efficiency to increase costs.

### **REASONS FOR MERGING OF FIRMS**

To reduce duplication of goods

To increase the level of exploitation of the country's resources

To improve on the quality of the goods produced

To enjoy economies of scale

To reduce on the costs of advertisement

To share risks

To attain monopoly

### **FACTORS HINDERING MERGING OF FIRMS.**

Small market of the product.

As firms merge, the level of output produced increases which output cannot be absorbed by a small market and this resulting into losses for the firms that have merged.

The anti-monopoly laws i.e. such laws put in place by the government hinder the merging of firms in order to prevent the abuse of monopoly firms that would otherwise exploit the consumers.

High taxation by the government

The government imposes high taxes on large scale firms or firms therefore becoming reluctant to merge such that they pay lower taxes.

Long distances between places where the firms are located. This makes it difficult to put the firms under one management as it becomes difficult to co-ordinate the productive activities of the firm that are required.

Differences in the objectives of the firms i.e. in situations where one firm aims at profit maximization while the other aims at sales maximization, merging may become impossible because of the conflicting objectives that may result into contradicting decisions and policies.

Fear of sharing losses. This makes it difficult for a firm making profits to merge with another firm that is making losses the firms may collapse together.

Fear of unemployment that may arise. As firms merge, some of the workers may have to be laid off and therefore the owner of the firm may prefer to remain as individual firms to maintain the employment.

Fear of diseconomies of scale. As firms merge, over expansion may take place which results into rising average costs (cost per unit of output and thus leading to losses).

### **SMALL SCALE FIRMS**

There are firms which produce low levels of output, employ a small number of people, mainly use poor technology and usually produce poor quality goods and services.

#### **Advantages**

They are highly flexible. This is because they can change easily from the production of one commodity to another; they can easily increase or reduce output and can also shift or change from one place to another.

They provide cheap and affordable goods and services to the population. Their products are relatively cheap compared to those of large scale firms because they incur lower costs and use cheap locally available inputs during production.

Small scale firms are easy to manage and control because they operate on small scale and in their management is not complex.

Lower taxes are imposed on small scale firms by the government. This is because they produce low levels of output.

Decision making is easy and quick with small scale firms. This is because they are usually owned by one or few individuals who sometimes family members implying that few consultations are made.

They are appropriate for small markets. This is because they produce low output which can easily be absorbed in a small market. They are easy to start or Setup. This is because they require little initial capital and are less costly.

Direct / personal contact with customers is easy and possible. This is because they normally have few customers and therefore can easily adapt to their needs

They provide employment opportunities to people. This is because they mainly use labour intensive technology and therefore employ more people compared to large scale firms which use capital intensive technology

They contribute towards government revenue. This is through payment of taxes imposed on them, their employees and the output they produce.

They lead to a reduction in income inequality. This is because they provide employment opportunities to the Nationals of the country who would otherwise be jobless.

Encourage use of local resources. They utilize locally available resources to production and therefore contribute to the exploitation of the country's resources.

They provide use of local technology. This is because most of the small scale; firms use technology that is available.

They provide development skills i.e. some people are able to develop large firms from the small scale firms.

### **Disadvantages**

They produce poor quality goods and services. This is because they employ semi-skilled and unskilled labour.

They lead to under utilization of the country's resources. This is because they produce a low output which results into low-levels of the country's N.T

They are associated with low contributions to the government revenue through taxation. This is because they mainly produce low output and the government imposes low taxes on them. They are associated with low contributions to employment in a country

They are associated with low profit levels because they produce low levels of output.

They are associated with low payment for the people they employ. This is because they produce low levels of output and earn less revenue from selling their output.

They have limited access to loans or financial assistance from the financial institutions. This is because they have limited assets to use as collateral security for borrowing.

They incur high costs per unit of output. This is because they provide low levels of output therefore do not employ large economies of scale.

### **LARGE SCALE FIRMS**

Large scale firms produce a large level of output and normally use intensive methods in production i.e. production methods that use more machines than labour.

#### **Merits**

They provide employment opportunities for the people since they operate on large scale; they therefore employ a large number of people.

They contribute towards government revenue. This is through payment of Taxes imposed on them by the government.

They promote exploitation of the country's resources. This is because they produce more output and this needs more input or raw material to use in production

They promote economic growth. This is increasing the output of goods and services and the GDP

They lead to development of skills for the people i.e. the individuals employed the firms acquire skills through training and operation of equipment in the firms.

They involve low costs of production per unit of output. This is because they produce a large output and therefore enjoy economies of large scale production.

They leads to increase in the country's foreign exchange earnings as some of their products are exported to other countries which lead to improvement in the country's B.O.P position.

They promote technological development and technological transfer, i.e. they import modern technique of production from other countries and also improve on the locally available technology through research innovations.

They produce and provide commodities at lower prices for the production. As they produce on a large scale and thus incur lower costs per unit of output.

They promote development of the country's infrastructure. This is because government normally improves and establishes infrastructure such as transport and communication network, power and energy projects in the areas where firms are located.

### **Demerits**

They lead to over exploitation and depletion of the country's resources. This is because they produce a large output and therefore over utilize the country's resources.

They lead to technological unemployment in the country. This is because due to the use of capital intensive methods in production.

They lead to imbalances in regional development. This is because the areas or regions where they are located tends to develop ahead of other regions in the country'

They promote rural-Urban migration and its associated evils. This is because people tend

to move from rural – urban areas where they are located resulting into negative effects in such areas.

Large scale firms lead to foreign dependence. This is due to the use of imported technology, imported raw materials.

They lead to capital outflows e.g. by promoting profit repatriation as most of them are owned by foreigners and also due to huge expense on imported inputs.

They lead to income inequalities in the country. This is because the people employed in sun firms are normally paid highly compared to those employed in other firms.

They overstrain the country's existing infrastructure e.g. transport and communication Network power and energy etc.

Establishment of large scale firms involves high costs of investment as huge amounts of K are involved in selling them up.

They result into over production and wastage of output especially where the market for the firm's products is small.

## THEORY OF COSTS

Costs refer to the expenses incurred by a firm during the production process. Costs include labourcosts (wages), rent insurance, transport costs etc.

The costs of production are mainly divided into two namely

- i. Variable costs
- ii. Fixed costs

### VARIABLE COSTS / DIRECT COSTS / PRIME COSTS / OPERATING COSTS

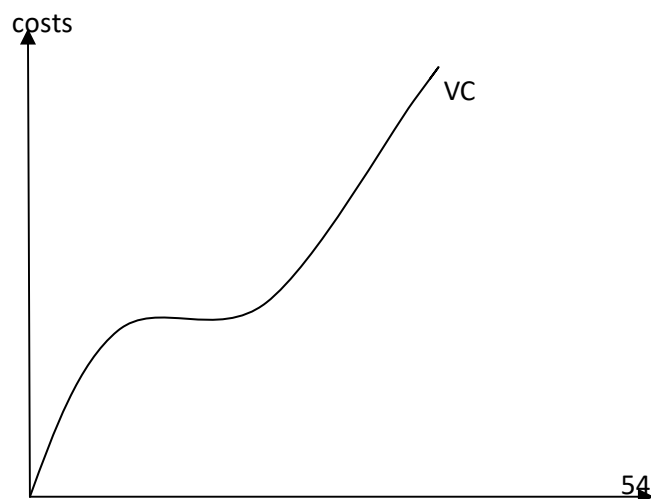
They are costs / expenses incurred by a firm in production that change directly with the level of output of the firm i.e. as the firms output increases, variable costs also increase and as the output reduces, variable costs also reduce.

Therefore when output = 0, variable costs are equal to zero.

Examples of variable costs

Wage (labour costs), costs of raw materials, transport costs etc.

Diagrammatically variable costs are illustrated as below.



0

Output

### **FIXED COSTS / SUPPLEMENTARY / INDIRECT / OVERHEAD COSTS**

These are expenses or costs that are incurred by a firm during production that remain constant irrespective of the level of output produced.

Therefore, fixed costs will remain the same whether the firm's output increases or decreases and they remain the same even when the firm's output increases and they remain the same when the output = 0

Examples include,

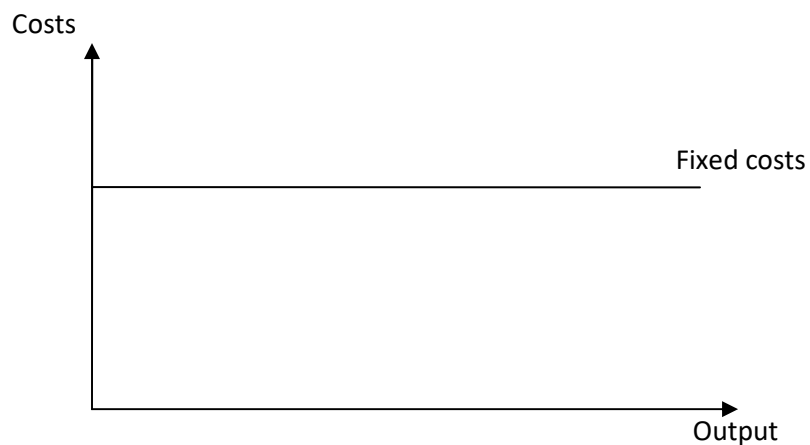
Costs on rent

Interest on loans or capital

Salaries of top management

Insurance premiums etc.

Diagrammatically, fixed costs are illustrated as below.



### **TOTAL COSTS**

These are the summations of variable costs and fixed costs i.e. total cost

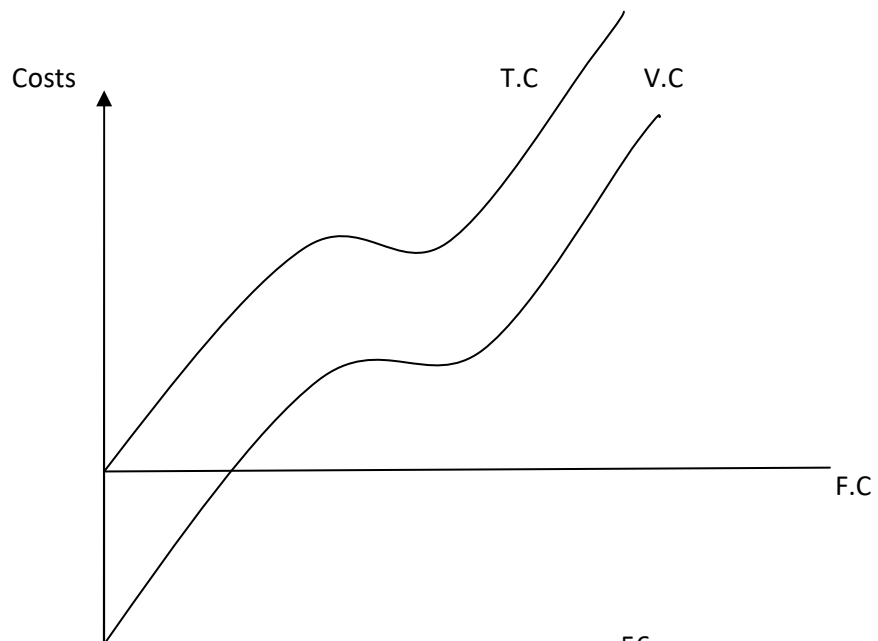
Total cost = Variable + Fixed cost

NB;

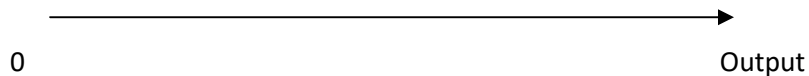
At zero output, total cost = Fixed cost because variable cost = 0

THE RELATIONSHIP BETWEEN COSTS (T C), VARIABLE COSTS (V.C), FIXED COSTS AND THE FIRMS LEVEL OF OUTPUT.

Output	TC	FC	VC
0	40	40	0
1	64	40	24
2	90	40	50
3	120	40	80
4	136	40	96
5	156	40	116







From the diagram above, we note the following

As the firm increase the level of output, V.C increases from 0 and thus the variable cost curve begins from the origin and rises towards the right (positive slope)

As the firm increases its level of output, fixed costs remains constant and that's why the fixed cost curve is a horizontal straight line

As the firm increases its level of output, the T.C of the firm also increases but they don't start from zero (origin) and instead they start from the level of fixed costs.

Complete the table below

Output (kg)	T.C	F.C	V.C
0	1000	1000	0
1	1600	1000	600
2	1850	1000	850
3	2000	1000	1000
4	2100	1000	1100
5	2150	4000	1150

## EXPLICIT COST AND IMPLICIT COST

Explicit cost refers to the expenses incurred by a firm on resources that are not owned by the firm but instead hired by the firm to carry out production. Eg. Transport costs on hired vehicles.

Implicit costs on the other hand are expenses incurred by a firm on inputs that are owned by the firm itself. These include costs of using vehicles used by the firm, costs of employing family members.

Employment of the owner of the firm himself

## PRIVATE COSTS AND SOCIAL COSTS

Private costs are expenses incurred by a firm or owner of the firm purchasing the inputs that are used in production.

Private costs include variable and fixed costs

Social costs are costs or expenses incurred by the society as a whole result of the firm's engagement in production in a given area.

They include pollution of the environment in form of noise, fumes from factories and dumping of waters in the environment.

### **PER- UNIT / COSTS PER- UNIT OUTPUT / AVERAGE COSTS / AVERAGE FIXED COST**

**Average costs.** These refer to the costs / expenses by the firm per unit of output produced. i.e.

$$A.C = \frac{\text{Total cost}}{\text{Output}}$$

**Average fixed cost:** these are fixed costs incurred by a firm per unit of output produced.

$$NB \quad AFC = \frac{FC}{Q} = \frac{TC - VC}{Q} = AC - AVC$$

### **Average variable costs**

Refer to the total variable costs per unit of output produced by a firm. i.e.

$$AVC = \frac{VC}{Q} = \frac{T.C - F.C}{Q} = AC - AFC$$

### **Marginal costs**

These refer to the additional / extra costs incurred by the firms in order to produce one extra or additional unit of output i.e.

$$MC = \frac{\Delta T.C}{\Delta Q}$$

Supposing a firm incurs total cost amounting to 10,000 to produce 10 bags of maize. Calculate the marginal cost if the total cost increased to 15,000/= as a result of increasing the output of the firm to 12 bags.

$$\text{Marginal cost} = \frac{\text{Change in total cost}}{\text{Change in output}}$$

$$\text{Marginal cost} = \frac{15,000 - 10,000}{12 - 10}$$

$$MC = 2500/=$$

### **IMPORTANCE OF MARGINAL COST**

Marginal cost is used to determine equilibrium level of output of a firm, at this level of output.

Marginal cost = Marginal revenue and the firm maximizes profits

It is used to determine the optimum output of the firm. Optimum output refers to the level of output produced by the firm at the lowest cost per unit cost (AC)

At the optimum level of output ,  $MC = AC$

It is used to determine the prices of commodities. The higher the marginal cost, the higher the price and the lower the marginal cost the lower the price.

Output(k g)	T.C	T.FC	TVC	AFC	AVC	ATC	M.C
0	40	40	0	0	0	0	-
1	64	40	24	40	24	64	24
2	94	40	50	20	25	4	26
3	120	40	80	13.3	26.7	40	30
4	136	40	96	10	24	34	16
5	156	40	116	8	23.2	31.2	20
6	174	40	134	6.7	22.3	29	18
7	204	40	164	5.7	23.4	29.1	30
1	224	40	184	5	23	28	20
9	260	40	220	4.4	24.4	28.9	36
10	308	40	268	4	26.8	30.8	48

Output(k g)	T.C	T.FC	TVC	AFC	AVC	ATC	M.C
0	20	20	0	-	0	0	-
1	34	20	14	20	14	34	14
2	45	20	25	10	12.5	22.5	11
3	60	20	40	6.7	13.3	20	15
4	68	20	48	5	12	17	8
5	78	20	58	4	11.6	15.6	10
6	87	20	67	3.3	11.2	14.5	9
7	102	20	82	2.9	11.7	14.6	15
1	112	20	92	2.5	11.5	14	10
9	130	20	110	2.2	12.2	14.4	18
10	154	20	134	2	13.4	15.4	24

Output(k g)	T.C	T.FC	TVC	AFC	AVC	ATC	M.C
0	600	600	0	-	0	0	0
3	1650	600	1050	200	350	550	350

4	1860	600	1260	150	315	465	210
5	2100	600	1500	120	300	420	240
6	2400	600	180	100	300	400	300
7	2800	600	2200	85.71	314.3	400.01	400
8	3400	600	2800	75	350	425	600
9	600	3700	66.67	411.1	477.77	900	900
10	5800	600	5200	60	520	580	1500

## OBSERVATION

As a firm increases the level of output:

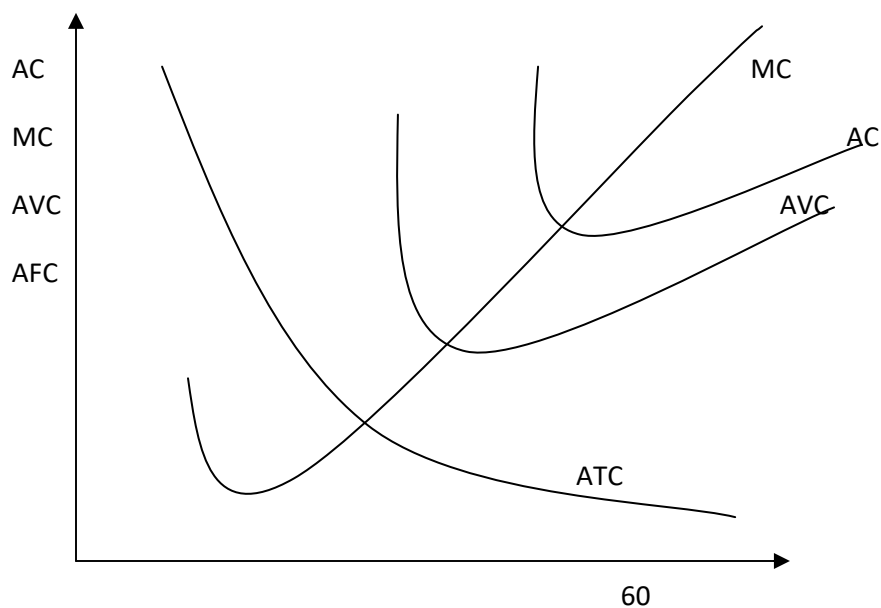
Average costs keep on reducing, reach a minimum point and start rising. Therefore the Average curve(AC) must be “U” shaped both in the short and long run.

The average fixed costs keep on reducing (as output increases). This is because the fixed costs are constant are spread over a larger output

The average variable costs (AVC) must begin by reducing, reach a minimum and then start rising up.

Therefore the AVC curve of the firm must both in the short and long run

Dramatically, the rising relationship between the AC, MC and AVC are illustrated as below



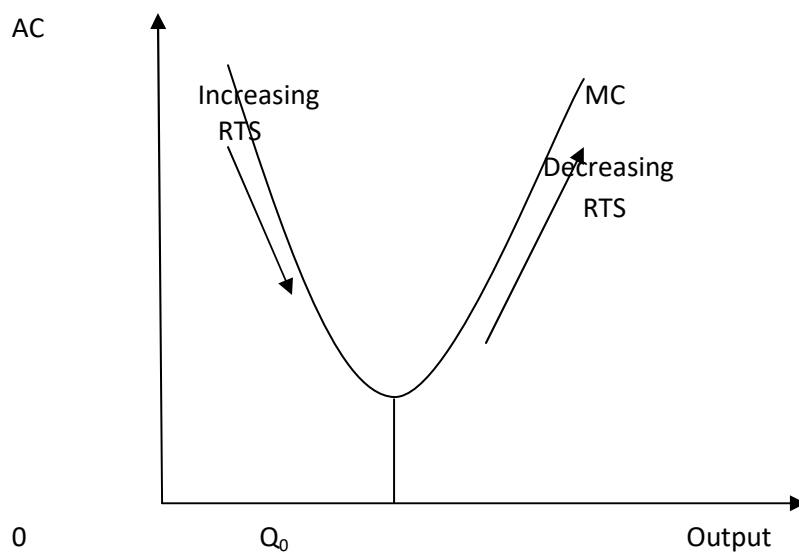
Output

NB: The AC is above the AVC curve because  $AC = AVC + AFC$

### REASONS FOR THE SHAPE OF THE AC CURVE OF A FIRM IN :

#### A short run

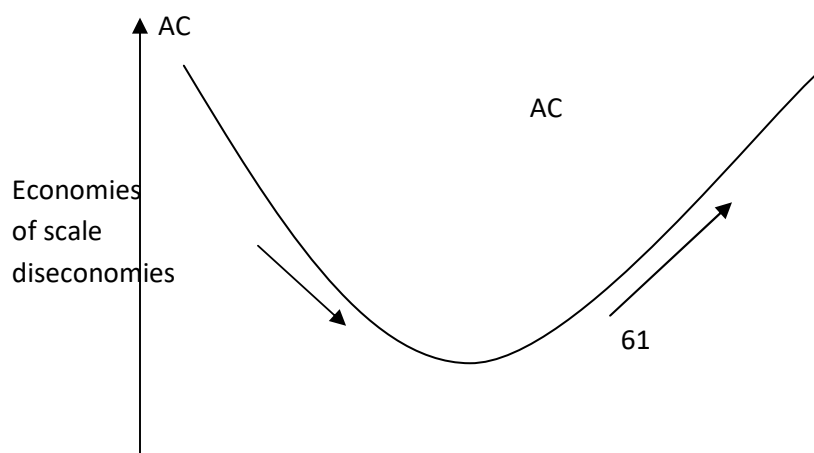
The short run AC curve is U shaped because of the law of diminishing returns



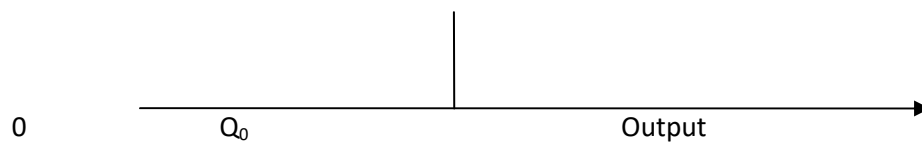
As the firm increases the output from 0 -  $Q_0$ , it experiences increasing returns which results into a fall in the average costs exploiting the downward portion of the A.C curve but as the firm increases output from  $Q_0$ , the law of diminishing returns comes in which results into increasing costs hence upward sloping of the average cost curve

#### Long run

In the long run, the AC curve of a firm is U shaped because of the economies and diseconomies of scale illustrated below.



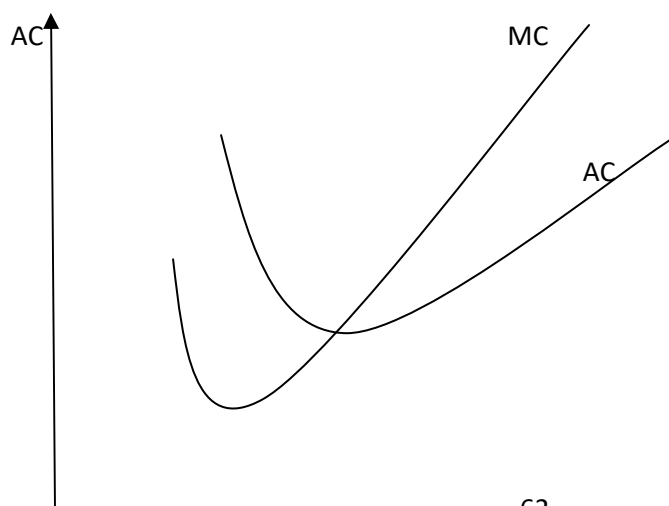
of scale



NB

THE AVC and the MC curve are also “U” shaped both in the short run and in the long run because of the same reasons as those of the AC curve.

#### THE RELATIONSHIP BETWEEN AVERAGE COST AND MC OF A FIRM



0 ————— Output

When the AC is falling, the MC must be less than AC

When the AC is rising, the MC must be greater than AC

When the AC is at its lowest, the MC must be = to AC

Both the AC and MC begin by falling, reach a minimum and start rising and therefore they are “U” shaped.

NB:

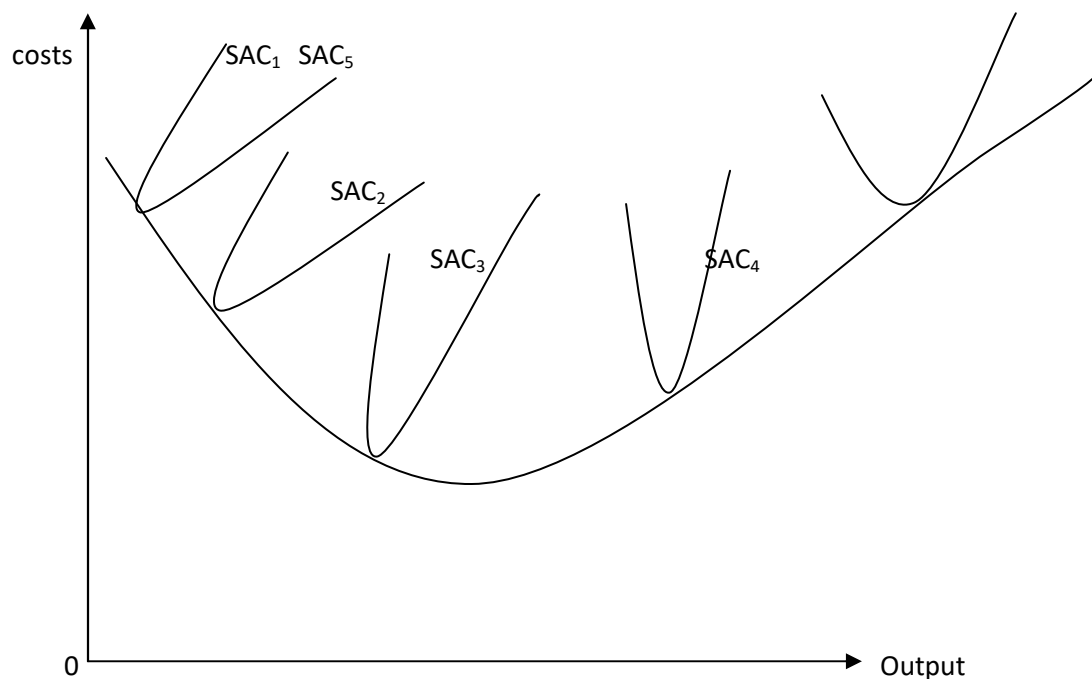
Statements 1 – 3 simply imply that the MC curve cuts the AC curve at the lowest point of the AC curve.

### THE RELATIONSHIP BETWEEN THE SHORT RUN A.C CURVE AND THE LONG RUN AC CURVE

The long run average cost curve is an envelope of short run AC curves and is sometimes referred to as an envelope curve or a planning curve of a firm.

NB

A long run curve refers to a locus of the minimum points short run A.C curves of a firm. Costs



## **ECONOMISE OF SCALE**

Economies of scale refer to the advantages enjoyed by a firm as result of operation on a large scale.

OR

These are benefits that accrue to the firm producing on a large scale. They are represented by the falling of the long run average cost curve because of their ability to reduce average costs.

## **REAL ECONOMIES OF SCALE AND FINANCIAL / PECUNIARY ECONOMIES OF SCALE**

Real economies of scale refer to the advantage of large scale production which are associated with a reduction in the physical quantities of the inputs used in producing units of output.

Financial / Pecuniary economies of scale refers to the advantages of large scale production employed by the firm which are in form of paying lower prices for the inputs used in production by the firm. These mainly come about as a result of purchasing inputs in bulk and therefore paying lower prices for them.

### **Internal economies of scale**

These are enjoyed by an individual firm as it expands scale of production which arises due to favorable conditions within the firm and leads to a fall in the average cost of a firm

Internal economies of scale arise out of better organisation within the firm and are enjoyed by an individual firm.

## **TYPES OR FORMS OF INTERNAL ECONOMIES OF SCALE**

### **Technical economies of scale**

These arise out of the use of modern and better techniques which leads to an increase in the output produced by the firm relative to the costs and thus leading to falling average costs for the firm.

### **Managerial / economies of scale**

These arise out of better activities of the firm e.g. through employing specialized managers and professionals, dividing management into various departments which increases the level of efficiency. This results into an increase in the output produced by the firm and eventually results into falling average costs of the firm.

### **Marketing E.O.S**

These include the buying and selling economies of scale at the firm expands its scale of production, it purchases inputs in large amounts or in bulk which results into enjoyment of discounts and payment of



lower prices for the inputs which reduces the average costs incurred by the firm. In addition, it becomes possible for the firm to advertise its products as well as distributing the products in different areas or market which results into lower average costs because those experiences spread over a large output.

#### **Financial E.O.S**

These are advantages that arise out of the firm being able to secure financial assistance e.g. loans from financial institutions are easily given and at a lower interest rate because a large firm has got more assets to present as collateral security for obtaining loans from the financial institutions. The low interest rates eventually lead to falling AC's incurred by the firm as it expands its scale of production.

#### **Transport E.O.S**

These are in form of payments or incurring lower transport costs per each unit of output. It becomes cheaper to transport a large output compared to a low output when we consider the costs per unit of output e.g. it's cheaper to hire a 10 tone lorry for transporting 10 tones than hiring the same lorry to transport 1 tone of output.

#### **Storage E.O.S**

These are in form of incurring costs per unit of output as the firm expands its level of output e.g. it is cheaper to hire a warehouse for storing 50 tonnes of output than hiring the same house for storing one tone of output.

#### **Research and development E.O.S**

It is possible for a large firm to carry out research for better methods of production, improvement in the quality, better markets for the firm's products etc because the cost of research can be spread over a large output which results into lower average costs.

### **EXTERNAL ECONOMIES OF SCALE**

These are advantages that are enjoyed by a firm due to expansion of the industry because of the favorable conditions created for the firm by the industry which leads to falling average costs incurred by the firm.

Such advantages are enjoyed by all the firms in the industry and are mainly associated with the benefits or advantages of localization of an industry.

#### **Types / forms OF Economies of Scale**

##### **Economies of concentration**

These are the advantages enjoyed by the firm when the industry is highly localized in a given area and include the development of a pool of skilled labour which can be obtained at lower cost, co-operation of

the firms when it comes to solving common problems, development of forward and backward linkage availability or developed infrastructure in the area, development of auxiliary services

#### Economies of information

As the industry expands in size, it can easily set up research units at low costs and can employ highly skilled personnel which can result into passing of information to other firms in the industry and even other industries which increases efficiency.

#### Economies of specialization

As the industry expands in size, firms specialize in different activities which lead to an increase in efficiency output and average costs

#### Economies of welfare

As the industry expands in size, it is in a better position to produce welfare facilities to the workers e.g. housing facilities, medical facilities transport etc

NB

#### DISECONOMIES OF SCALE

These are disadvantages of large-scale production that are faced / experienced by a firm or industry resulting into increasing large costs therefore diseconomies of scale are seen when either due to internal and external factors.

Diseconomies of scale are divided into two namely

Internal diseconomies of scale

External diseconomies of scale

#### **INTERNAL DISECONOMIES OF SCALE**

These are disadvantages of large scale production that result into increasing or rising average costs that are experienced / faced by an individual firm as it expands in its scale of production.

#### **TYPES OF INTERNAL DISECONOMIES OF SCALE**

##### **Technical diseconomies of scale**

These are disadvantages of large scale production in form of increasing average costs that are experienced by a firm as a result of increasing expenses on repairing and replacement of machines that are worn out so as to maintain production.

### **Buying diseconomies of scale**

Disadvantages of large scale production inform of increased expenditure on purchasing inputs so as to continue with large scale production which eventually leads to rising average costs. They are namely brought about by increased competition for the inputs as the firm continues to produce a large scale.

### **Selling diseconomies of scale**

This comes out as it becomes expensive for the firm to sell or market its output which requires a lot of advertisement, transportation and distribution of the products in different markets, all of which lead to rising costs

### **Managerial diseconomies of scale**

These come up when the management and admin within the firm becomes more complex and inefficient because of large scale production. Because of this unnecessary delays in communication between managers and delays in policy implementation leads to time wastage, all of which lead to increase to the increase in the average costs (costs of production per unit of output)

### **Financial diseconomies of Scale**

These are disadvantages that arise due to increased expenses on repayment of loans inform of high interest which results into rising average costs

### **Labour diseconomies of scale.**

These come up when the firm starts incurring high costs on paying labour because of the increasing demand for labour e.g. skilled labour which results into rising average costs.

### **EXTERNAL D.E.O.S**

These are disadvantages of large scale production that lead to rising costs which come about as a result of expansion of the industry. Like external economies of scale, external diseconomies of scale are mainly experienced when the industry is highly localized and are therefore seen as large disadvantages of localizing

They include the following

Pollution of the environment (atmosphere and H<sub>2</sub>O bodies). Such pollution may require costs of purification

Over exploitation and depletion of resources in the area which results into higher prices for them.

Increased pressure on the existing infrastructure. The increased pressure and competition on facilities such as power, H<sub>2</sub>O etc leads to higher prices for the factor inputs because of the increasing demand by the industry.

1. Displacement of people
2. Increased competition for labour which results into higher expenses for labour

## REVENUE OF THE FIRM

Revenue refers to the amount of money that is received by a firm out of selling its output. Revenue is divided into three categories namely.

Total revenue

Average revenue

Marginal revenue

Total Revenue (T.R)

This refers to the total amount of money received by the firm out of selling its output. Total revenue is output by multiplying the amount of wood sold (Q) by the price of each unit of output i.e.  $T.R = P \times Q$

Average Revenue

This refers to the total revenue per each unit of output i.e. average revenue

$$\text{Average Revenue} = \frac{\text{Total revenue}}{\text{Output sold Q}} \quad T.R = AR$$

NB

Average revenue is the same as price and this can be proved as below

$$AR = \frac{T.R}{Q} \text{ but } TR = P \times Q$$

$$AR = \frac{P \times Q}{Q}$$

$$AR = P$$

Marginal revenue

This refers to the additional revenue received by a firm as a result of selling one extra unit of output

$$\text{Marginal revenue} = \frac{\text{Change in Total cost}}{\text{Change in output}}$$

$$MR = \frac{\Delta T.C}{\Delta Q}$$

It should be noted that the revenue curves of firms change / vary from one market structure to another while the cost curves are the same for all firms for market structures.