TOPIC 3: PRODUCTION THEORY & MARKET STRUCTURES
PRODUCTION THEORY
Production theory is the study of production, or the economic process of converting inputs into outputs. Production uses resources to create a good or service that is suitable for use

Production is a technical term which refers to the process of transforming resources into output of goods and services aimed at satisfying human wants

It thus involves the creation of utility in goods and services aimed at satisfying the wants of individuals or groups of individuals

It covers such areas as manufacturing, construction, provision of services, extractive industries etc

Aim of production
Production is a process that combines various material inputs and immaterial inputs (plans, know-how) to make something for consumption (the output). It is the act of creating output, a good or service that has value and contributes to the utility of individuals

The aim or purpose of all production is the satisfaction of human wants. Man's needs can be satisfied directly through production of goods or services for one's consumption or indirectly through production of goods to satisfy other people's wants for example production for the international market

Production also aims at improving on main's social and economic welfare and enabling man to earn a living. Economic well-being is created in a production process, meaning all economic activities that aim directly or indirectly to satisfy human needs. The degree to which the needs are satisfied is often accepted as a measure of economic well-being. In production two features explain increasing economic well-being. They are improving quality price ratio of commodities and increasing incomes from growing and more efficient market production

NB: Utility is the ability of or usefulness in a good or service to satisfy human wants. The people who contribute towards the provision of goods and services for the welfare of human society are called producers

Stages of Production
1. Primary Production involves production of goods made available by nature, which is, harvesting of the products of nature. It includes extractive occupations like farming, mining, quarrying, fishing, lumbering etc
2. Secondary production involves the process of transforming raw material made available by nature into a useful form. It is classified into manufacturing (textiles, food processing, oil refining etc) and construction (of buildings, roads, bridges, dams etc)
3. Tertiary production involves the provision of services either commercial (insurance, transport, banking, trading, advertising etc) or personal/direct (medical teaching, guarding etc)

Note *You may not write that work in italics but it's for you to read and get an in-depth understanding of the concept*

Production as a process of creating wealth

Production aims at creating both goods and services. Therefore, at any given time in an economy, there exists a definite amount of goods. This comprises the country's wealth. Thus, wealth is the stock of goods existing in a country at a particular time

Wealth must satisfy the following conditions

- *Be relatively scarce*

- *Must possess utility*
- *Must command money value or price*
- *Be marketable or transferable*

Wealth can be categorized as

- *Business wealth, this is a firm's stock of assets like machinery, buildings, vehicles etc used in business*
- *Personal wealth is one which consists of personal assets that satisfy an individual owner*
  Or it refers to wealth in form of assets that satisfy individual needs of a person/owner
- *Public/social wealth is one which consists of assets or resources owned by the state and are meant to benefit all citizens*

SUBSISTENCE SECTOR AND THE MONETARY SECTOR

Distinguish between the subsistence sector and the monetary sector

Subsistence sector is one where production is for one's own consumption and exchange. If any is by barter

While

Monetary sector is one where production is for the market and exchange for goods is by means of money

Subsistence production – production for the producers' own consumption

NB: Subsistence output is the amount of goods produced for own/self/use/consumption

Features of subsistence sector

- Farming is done on small holdings
- Family labour is mainly used
- Limited degree of specialization
- Mainly use of simple techniques of production
- Exchange is mainly by barter
- Highly dependent on nature hence high risks and uncertainty
- Mainly low levels of output
- Mainly poor-quality output

Reasons for the persistent dominance of the subsistence sector in most developing countries

- Limited market/small domestic market
- Limited entrepreneurship skills
- Poor land tenure system
- High taxation in the commercial sector/less conducive government policies on investment eg high taxation
- Conservatism of our people
- Low income making it difficult to invest in other sectors/limited capital required for large scale production
- Poor infrastructure
- High population growth rate and the problem of dependence
- Unstable prices of primary products
- Limited supply of some inputs/raw materials
- Poor skills/limited skills in the fields of management and production

The demerits of a large subsistence sector in Uganda (problems of over relying on subsistence production)

- Low quality output
- Low economic growth rate/low quantity of output
- High levels of under-employment and seasonal unemployment
- Low tax revenue
- Under exploitation of (natural) resources/leads to underutilization of available resource

- Limited specialization and trade
- Limited innovation and creativity in the sector

Measures that can be taken to reduce dominance of the subsistence sector

Attempts being made to reduce the dominance of subsistence sector in Uganda include

- Equip farmers with skills through training. Training programme to impart more skills
- Provision of incentives for example subsidies
- Set up small scale industries
- Improve or develop infrastructure
- Encourage co-operative societies
- Set up research institutes to carry out technological development
- Creation of market for locally produced goods
- Encourage land reforms
- Provision extension services
- Diversification of agricultural activities
- Modernisation of agriculture
- Provision of inputs and goods seeds/provide subsidies to small scale producers
- Provision of credit facilities
- Control population growth rates

Reasons as to why there is need to reduce the size of the subsistence sector in an economy

- To increase productivity
- To encourage monetization of the economy
- To encourage improvement in the quality of final goods through competition
- To improve the living conditions and livelihood of the rural people
- To generate more employment opportunities and hence check the problem of disguised unemployment
- To widen the tax base due to expansion of production for the market
- To increase rural incomes due to increase in the volume of production
- To accelerate rural transformation
- To expand the market for industrial output, especially output used as inputs in the agricultural sector like fertilizers
- To encourage innovation and creativity due to competitive production

AGENTS/FACTORS OF PRODUCTION

These are resources or inputs used in combination to enhance the production process

Or

They are resources or inputs used in the production of goods and services

Agents of production in Uganda include

- Land
- Labour
- Capital
- Entrepreneurship
- Organization

Factors or agents of production and their rewards include

(a) Land refers to all gifts of nature, that is all things provided free by nature and they are freely available on, above and below the surface of the earth. Its reward is rent

(b) Capital, it refers to all manmade physical assets or items that assist human labour in the production process, including already produced goods in production of other goods and services like money, tools, machinery, vehicles etc. the reward is interest

(c) Labour, refers to the physical and mental effort directed towards production of a good or services. Labour is both skilled and unskilled, mental and manual. The reward is salary/wage

(d) Organization/management/administration, this brings together and co-ordinates other factors to ensure a smooth production process. Organization does not take part in actual process of transformation of raw materials to finished goods. The reward is salary

(e) Entrepreneurship (ownership), this is undertaking the investment in the project buying land etc. an entrepreneur pays for other factors of production, bears the risks/losses and enjoys the profits. The reward is profit

NB: Factors of production, these are the agents or the inputs of production ie the resources that are used to facilitate the production of goods or service

FACTOR PRICES

Factor prices are monetary values or monetary payments to factors of production for their contribution to production of goods

They include

- Interest for capital
- Wage/salary for labour
- Profits for entrepreneurship
- Salary for organization
- Rent for land

NB: Rent is a monetary reward a factor of production receives over and above its supply price OR the monetary payment or reward for use of land

LAND

Land or natural resources – naturally occurring goods like water, air, soil, minerals, flora and fauna that are used in the creation of products. In economics, land comprises all naturally occurring resources whose supply is inherently fixed (1). Examples are any and all particular geographical locations, mineral deposits, forests, fish stocks, atmospheric quality, geostationary orbits, and portions of the electromagnetic spectrum. Natural resources are fundamental to the production of all goods, including capital goods. The payment for use and the received income of a land owner is rent

MOBILITY OF LAND

This is the ease with which land as a factor of production can move from one occupation or location or location to another

Or

The ability of land to move from one occupation or geographical area to another. It may be **Occupational or geographical**

Occupational mobility of land is the ease with which land can move from one occupation to another

While

Geographical mobility of land is the ease with which land can move from one location to another

Factors that limit occupational mobility of land

- Unsuitability of land for alternative occupation
- High costs involved in changing occupation
- Poor location of land
- Low pay to land in alternative occupation
- Poor land tenure system eg communal ownership of land
- Conservatism
- Owner unwilling to sell land

LABOUR

Labour refers to any human effort, whether physical or mental that is utilized in the production process

Labour – human effort both physical and mental used in production which also includes technical and marketing expertise. The payment for someone else's labour and all income received from one's own labour is wages or salary. Labour can be also be classified as the physical and mental contribution of an employee to the production of the good(s)

Significance of labour in the production process

- Labour creates capital or wealth from the reward it gets
- Labour determines values. The value of a good depends on the amount of labour used to produce it
- Labour utilizes land and capital and without it remain idle
- The quality and quantity of labourforce, well-motivates and having co-operant factors makes effective utilization and exploitation of natural resources which raises output
- Labour is the end for which production is undertaken, that is, the need to satisfy human wants

PRODUCTIVITY OF LABOUR

Productivity of labour is the amount of output produced per unit of labour employed (during a given period of time)

Or

It is the measure of output per unit of labour employed (in a given period of time)

Factors which determine the productivity of labour in Uganda

- Wages (motivation/remuneration/terms of service). High wages offered to labour make it motivated to work harder leading to high level of productivity while low wages offered to labour make it discouraged and work less leading to low levels of productivity
- Level of technology. High level of technology enables labour to work faster leading to high levels of productivity while use of inappropriate (poor) technology slows down the working pace of labour leading to low level of productivity
- Level of skills/ability/education and training. High levels of skills make labour perform and apply novel ideas faster leading to high level of productivity while low levels of education (skills) make it difficult for labour to learn new tasks faster leading to low level of productivity
- Level of experience. High levels of experience make labour able to complete tasks faster leading to high level of productivity while low levels of experience and expertise make a worker take long to complete tasks leading to low level of productivity
- Availability and quality of co-operant factors; high quality and quality of cooperant factors leading to high level of productivity while limited quality and quantity of co-operant factors particularly capital and raw materials leading to low level of productivity
- Quality of management/level of organization of production process/supervision. High quality of management results into better supervision of workers leading to high levels of productivity while poor quality of management results into poor supervision of workers leading to low level of productivity
- Level of inventions and innovations; high level of innovations and inventions make workers able to discover new ways of producing more output leading to high level of productivity but limited innovations and inventions make it impossible for a worker to discover new and better ways of producing more output leading to low level of productivity
- Working conditions, better working conditions raise the morale of the workers thus motivating them to work harder leading to high level of productivity but poor working conditions kill the morale of workers thereby discouraging them to work harder leading to low level of productivity
- Attitude to work. Good attitude towards work makes labour to work harder leading to high level of productivity but poor attitude towards work makes labour to work less leading to low level of productivity

- Natural ability/talent; highly talented labour is able to produce a lot of output within a very short period of time leading to high level of productivity while limited talents or natural ability make labour slow at work and thus produces low output in a given time leading to low level of productivity
- Political climate; political stability gives confidence to workers to concentrate on their work leading to high level of productivity while political unrest in some areas makes workers scared about the safety of their lives and property thus concentrate less at work leading to low level of productivity
- Physical ability/health conditions of workers, a good health conditions of workers make actively attend to his work leading to high level of productivity while poor health conditions of workers make a worker inactive at the place of work leading to low level of productivity
- Level of specialization in production. High level of specialization in production makes it possible for a worker to produce more output within a short time leading to high level of productivity while limited specialization in production makes a worker slow at work and produce low output leading to low level of productivity

Factors which may lead to an increase in the productivity of labour

- Increase in the level of wages
- Improvement in the technology/technological progress
- Improvement in the quality of management
- Increase in the level of skills
- Improvement in the working conditions
- Positive changes in attitude towards work
- Improvement in political climate
- Increase in the level of inventions and innovations
- Increase in the level of specialization in production
- Increase in the availability and quality of co-operant factors
- Improvement in the health conditions of labour
- Increase in experience and expertise

REASONS FOR LOW LABOUR PRODUCTIVITY IN UGANDA

Factors responsible for low labour productivity in my country are as follows;

- Limited skills/low levels of sills/low level of education
- Low wages/poor rewards to labour/poor remuneration of workers
- Limited quality and quantity of co-operant factors particularly capital and raw materials
- Poor management/organization of labour (poor supervision of workers)
- Poor attitude towards work
- Low level of specialization/limited specialization in production
- Poor working conditions/environment
- Low level of innovation and inventions/limited creativity
- Unfavourable political climate/political unrest in some areas
- Low level of technology/poor technology/use of inappropriate technology
- Poor health conditions of workers
- Limited natural ability/limited talents
- Low levels of experience and expertise

EFFICIENCY OF LABOUR

This is the measure of the quality and quantity of output that a unit of labour can produce in a given period of time

Or

Efficiency of labour is the ability of labour to achieve greater output in a shorter time without any decline in quality of work/output

Factors that influence or determine the level of efficiency of labour
Summary

- Natural ability or talent
- Level or innovations and inventions
- Physical ability or strength (health conditions of workers)
- Wages (motivation/remuneration/terms of service)
- Level of technology
- Level of skills/ability/education and training/experience
- Availability and quality of co-operant factors
- Quality of management/level of organization of production process/supervision
- Working conditions
- Attitude towards work
- Political climate
- Level of specialization or division of labour.

AN INDEPTH EXPLANATION OF DETERMINANTS OF THE LEVEL OF EFFICIENCY OF LABOUR

- Wages (motivation/remuneration/terms of services). High wages offered to labour make it motivated to work harder leading to high level of labour efficiency while low wages offered to labour make it discouraged and work less leading to low level of labour efficiency
- Level of technology, high level of technology enables labour to work faster leading to high levels of labour efficiency while use of inappropriate (poor) technology slows down the working pace of labour leading to low level of labour efficiency
- Level of skills/ability/education and training. High levels of skills make labour perform and apply novel ideas faster leading to high level of labour efficiency while low levels of education (skills) make it difficult for labour to learn new tasks faster leading to low level of labour efficiency
- Level of experience, high levels of experience make labour able to complete tasks faster leading to high level of labour efficiency while low levels of experience and expertise make a worker take long to complete tasks leading to low level of labour efficiency
- Availability and quality of co-operant factors; high quantity and quality of cooperant factors leading to high level of labour efficiency due to production of more output of high quality while limited quality and quantity of co-operant factors particularly capital and raw materials lead to low level of labour efficiency as limited output of poor quality is produced
- Quality of management/level of organization of production process/supervision; high quality of management results into better supervision of workers leading to high level of labour efficiency while poor quality of management results into poor supervision of workers leading to low level of labour efficiency
- Level of inventions and innovations; high level of innovations and inventions make workers able to discover new ways of producing more output and of high quality leading to high level of labour efficiency but limited innovations and inventions make it impossible for a worker to discover new and better ways of producing more output leading to low level of labour efficiency
- Working conditions; but working conditions raise the morale of the workers thus motivating them to work harder leading to high level of labour efficiency but poor working conditions kill the morale of workers thereby discouraging them to work harder leading to low level of labour efficiency
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- Physical ability/health conditions of workers; good health conditions of workers make a worker actively attend to his work leading to high level of labour efficiency while poor health conditions of workers make a worker inactive at the place of work leading to low level of labour efficiency
- Level of specialization in production; high level of specialization in production makes it possible for a worker to produce more output and of high quality within a short time leading to high level of labour efficiency while limited specialization in production makes a worker slow at work and produce low output often of poor quality leading to low level of labour efficiency

Factors that limit labour efficiency

- Poor working conditions
- Low wage rates
- Low levels of/limited education and training
- Inadequate co-operant factors/limited co-operant factors
- Poor management
- Low levels of/limited motivation
- Low levels of specialization/limited specialization
- Limited experience
- Poor attitude toward work

Measures that can increase labour efficiency

- Encourage education and training of labour to improve skills
- Increase wages of labour
- Improve the working conditions of labour
- Improve the level of technology used in production
- Improve the level of management and supervision of the production process
- Encourage specialization and division of labour
- Improve the health conditions of labour

LABOUR SUPPLY

Labour supply is the number of hours of work labour is willing to work for a given wage rate over a given period of time

Or

The number of workers/people who are willing to work at a given wage rate during a given time

Factors that influence/determine/affect supply of labour

- Health conditions of workers. Better health conditions of workers make them more active and they do not miss work leading to high supply of labour but poor health of workers makes them inactive and they sometimes miss work leading to low supply of labour
- Size of the population. A population size that is big means there are more people to work hence high supply of labour but when the size of the population is small, it means there are few people to work hence low supply of labour
- The age composition of the population. When the majority of the population is a working population, then supply of labour is high but when few people are of working age, the supply of labour is low
- Working conditions. Good working conditions encourage many people to work leading to high supply of labour but poor working conditions discourage many people working leading to low supply of labour

- Political climate. Political stability makes people feel secure to work hence high supply of labour but publitical unrest makes people be in constant fear for their lives hence low supply of labour
- The sex ratio. In terms of sex composition, a population dominated by female results in low supply of labour while a population dominated by the males leads to high supply of labour
- The retirement age/the legal working age. The higher the retirement age, the greater the supply of labour but the lower the retirement age. The lower the supply of labour
- The cost of living. Low cost of living leads to high supply of labour while high cost of living leads to low supply of labour
- The social restrictions. High social restrictions lead to low labour supply while limited social ties lead to high labour supply
- The discrimination in the labour market on the basis of gender, race etc high level of discrimination in the labour market limits labour supply while absence of discrimation in the labour market leads to high labour supply
- Trade unions' influence. Artificial limits to an industry's labour supply (eg through the introduction of minimum entry requirements) can restrict labour supply and force pay levels higher – this is the case in professions such as legal services and medicine where there are strict "entry criteria" trade unions that have great influence restrict labour supply so as to raise the members' wages but trade unions with less influence cannot restrict labour supply since thee is minimal influence on employers leading to high supply of labour
- The level of knowledge of job opportunities. High level of knowledge of existing job opportunities, makes the supply of labour high as more people get the advertised jobs but when the level of knowledge is low, the supply of labour is low as fewer people get to know of available job vacancies
- The level of migrations/net migration of labour. A high immigration rate makes the level of supply of labour high because there are more people to work but when the emigration rate is high, the supply of labour is low because there are few people to work

  Uganda is a member of the East African Community's single market that enshrines free movement of labour as one of its guiding principles. A rising flow of people seeking work in Uganda is making labour migration an important factor in determining the supply of labour available to many industries – be it to relieve shortage of skilled labour or to meet the seasonal demand for workers in agriculture and the construction industry
- Attitude of labour towards work. A positive attitude towards work implies more people are willing and have a strong attachment to work hence supply of labour is high but when it is negative, people are not willing to work, hence low supply of labour
- The level of mobility of labour. The easier workers find it to change or move from one job or geographical area to another, the higher the supply of labour but when the level of mobility of labour is low, it means few people are willing to move from one job or tea to another hence low supply of labour. Likewise, improvements in the occupational mobility of labour increase labour supply, for example if more people are trained with the necessary skills required to work in a particular occupation, there is an increase in supply of labour
- The level of wages. Higher wages raise the prospect of increased factor rewards and should boost the number of people willing and able to work. Since when the level of wages is high, many people are motivated to work because work is more attractive compared to leisure leading to high supply of labour but when the level of wages is low, many people are demotivated and discouraged to work leading to low supply of labour
- The nature of the jobs/the degree of occupational hazards. Unpleasant jobs will have less people willing to do them therefore supply will be relatively lower. When a job is risky, people are discouraged to work for fear of contracting diseases or even losing their lives at work hence the supply of labour is low

but when a job is non risky, people are encouraged to work because their lives are not in danger hence high supply of labour

- Duration of studies/the length of the training period. A long period of training puts some people off the occupation and also means there is a delay before those who are willing to take it up are fully qualified to join the labourforce hence low supply of labour
- The level of skills required in a particular job. The more qualifications and skills required, the lower the supply of labour because it takes years to gain the requisite qualifications and experience but the lower the level of skills required, the higher the supply of labour because there are many people who have limited skills

DEMAND FOR LABOUR

It refers to the number of workers or people an employer is willing to employ (offer jobs) and retain in employment at a given wage rate at a given time

Or

It is demand derived from demand for the products labour is required to produce

Or

The demand for labour due to the demand for what it helps to produce

Or

Refers to the total number of workers/employees that an employer is willing and able to offer jobs and retain in employment at a given wage rate in a given period of time

Demand for labour is a derived demand. This means it depends on demand for the product the worker is producing. If there was no demand for economics lessons, there would be no demand to employ economics teachers. Demand for labour also depends on the productivity of the worker (how much they produce)

Factors that determine/affect/influence the demand for labour

The demand for labour depends upon;

- The level of demand for a product that labour helps to produce. A rise in the level of consumer demand for a product means that a business needs to take on more workers leading to high level of demand for labour due to the high expected revenue from increasing production but a low demand for the product labour produces makes it difficult to employ more workers and instead compels the entrepreneur to downsize the workforce leading to low demand for labour
- The level of wages or price of labour. A rise in the level of wages above productivity results into increase in costs hence reducing demand for labour because it is most costly to hire extra employees but when wages are lower, labour becomes relatively cheaper than for example using capital inputs. A fall in the wage rate thus leads to an expansion in labour demand
- The level of skills of labour. High level of skills possessed by labour as required by the employer leads to high demand for labour while limited skills possessed by labour in comparison to what is required by the employer leads to low demand for labour
- The availability of co-operant factors, for example, land, capital, etc to complement labour. High quantity of available co-operant factors like capital leads to high demand for labour to drive the machines but limited quantity of co-operant factors leads to a decline in demand for labour
- The proportion of the cost of labour to the total cost of production. A low proportion of labour costs to the total cost of production leads to high demand for labour while high proportion of labour costs to the total cost of production leads to low demand for labour
- The possibility of substituting labour for other factors of production/the level of substitutability of labour. The easier it is to replace labour with machines in the production process, the lower the demand for labour while the more difficult it is to replace labour in production, the higher the demand for labour, for example demand for labour is high in activities like tea and coffee picking

- The amount of output of labour (the productivity of labour/the level of marginal productivity of labour). The higher the output per worker, the more attractive is labour as a resource leading to high demand for labour while low productivity of labour makes using labour more costly and inefficient than using capital equipment leading to low demand for labour

Marginal Revenue Product of labour (MRP_L)

This is an economic theory which suggests demand for labour depends on the marginal revenue product of a worker

Definition of MRP

This is the extra revenue a firm gain from employing an extra worker. It depends on a worker's productivity (MRP) and the Marginal Revenue (MR) of last good sold

Definition of Marginal Physical Product (MP)

This is the extra output that an extra worker produces

- Due to the law of diminishing returns, in the short run, there is usually a diminishing marginal product when increasing the number of workers

Marginal Revenue (MR)

This is the revenue that a firm gain from selling the last unit of output. It is closely related to the price of the good sold

MARGINAL PRODUCTIVITY OF LABOUR

Marginal productivity of labour refers to the quantity of output that can be produced or realized from the employment of one extra unit of labour

Limitations to productivity of labour in developing countries include

- Limited capital
- Limited skills
- Poor techniques of production
- Limited supply of raw materials
- Poor attitude towards work
- Poor working conditions
- Poor entrepreneurial ability
- Low wages
- Poor land tenure system
- Physical disability
- Unfavourable political climate
- Limited natural ability/talents

Average product of labour is the output per unit of labour employed

Factors which may increase the average product of labour are;

- Increased training or education of labour
- Improved working conditions or welfare
- Improved nature of co-operant factors for example capital, and quality of land
- Increased specialization or division of labour
- Increased wages or remuneration
- Improved level of technology
- Positive attitude towards work

Marginal product of labour(MP_L)

Marginal product of labour is the additional output yield when an additional unit of labour is employed

The factors that may lead to increase in marginal product of labour are;

- Increase in the wage rate
- Improvement in technology

- Increase in the level of education/training/skills
- Improvement in the quality of management and supervision
- Increase in the availability and quality of cooperation factor
- Improvement in the working conditions
- Improvement in attitude of labour towards work
- Increase in the level of specialization and division of labour
- Improvement in political climate increase experienced expertise
- Improvement in health conditions of the worker

NB: Average product of capital is the output per unit of capital employed

While

Marginal product of capital is the additional output resulting from employment of an extra unit of capital

LABOUR FORCE

Labour force is the proportion of the population that is made up of the working age group, excluding full-time students and housewives.

It is the total number of people of the working age group that is available for employment at a given time

Or

Is the proportion of the population is in the working group excluding full-time students

Characteristics/features of Uganda's labour force

- Mainly youthful
- Slightly more females than males
- Mainly employed in the primary sector
- Mainly semi-skilled and unskilled
- Mainly rural based
- Many are employed in the public sector
- May are unemployed and underemployed
- Majority of the labourforce is not unionized
- Some are poorly deployed to occupations which do not match their skills

Determinants of the size of labour force

- Size of the population
- Number of full-time students/lengths of training periods
- Health status of the population
- Government policy in terms of employment age/age structure
- Social customs/number of full-time housewives

LABOUR MOBILITY

Labour mobility refers to the ability/the degree the ease with which labour moves either geographical or occupationally

Types of labour mobility

Mobility of labour is of the following types

(i) **Geographical mobility.** It means the ease with which labour can move from one place to another

(ii) **Occupational mobility.** It refers to the ease with which labour can move from one job to another. This may be through

Horizontal mobility. Horizontal mobility of labour is the ease with which labour can move from one job to another having similar status or salary in the same or some other profession

Or

Is a worker's ability to move to another job at a similar pay grade

Vertical mobility. It is the ease with which a worker can move from a junior position to a senior position
Or
Is the worker's ability to move up and down the employment hierarchy

(iii) Social mobility. It is the ease of movement of a worker from one social class to another eg the daughter of a peasant becoming a doctor

Question: Explain the factors that influence labour mobility in an economy

The factors that influence/affect/determine labour mobility in an economy

- ➢ The wage paid in current job or area. High wage paid to a worker in the present occupation provides a higher income and makes work more attractive hence his or her occupational mobility will be lower while low wages in the current job make labour occupationally mobile
- ➢ The working conditions in the current job or area. Better conditions of work in the present occupation provides worker's with higher job satisfaction, hence his or her occupational mobility will be lower while poor conditions of work at the current job make labour occupationally immobile
- ➢ The knowledge or information regarding other available jobs. Increasing the availability of information about job vacancies helps workers find new jobs, thus helps increase occupational mobility of labour while ignorance of available job opportunities elsewhere limits occupational mobility
- ➢ The degree or level of specialization by labour. Some occupations require specialized skilled and training. It would be difficult for new workers without such skills to enter such industries. Existing workers tend to be less willing to give up their present occupation. All these reduce occupational mobility of labour. On the contrary, jobs that do not require specialized skills and training encourage occupational mobility since there is no mismatch between the skills on offer from the unemployed and those required by employers looks for workers
- ➢ The influence of social or family ties. Strong family and social ties in form of home sickness limit occupational mobility of labour while labour with limited attachment to the family is occupationally mobile
- ➢ The influence of social restrictions eg religious and cultural. High social restrictions limit entry into certain occupation making labour immobile while limited influence of social restrictions encourages occupational mobility of labour
- ➢ Political climate in areas where other jobs are. In a political unstable region, worker tends to be more geographical mobile while present of peace and security in a given location limits geographical mobility of labour
- ➢ Degree or level of possession of the required/appropriate skills for other jobs. High educational attainments and taking retraining programmes can help workers acquire the skills demanded by some jobs. This can increase occupational mobility of labour. On the contrary, for workers with low education levels, new employment opportunities tend to be of a different nature (temporary, no security) and therefore, they are occupationally immobile
- ➢ The period of training period for other jobs. Long period of training needed for other jobs makes existing workers tend to be less willing to give up their present occupations which reduces occupational mobility of labour while short periods of training needed for the alternative jobs encourages occupational mobility of labour
- ➢ The cost of training needed for other jobs. High cost of training needed for alternative jobs makes labour occupationally immobile as labour may not be in position to fund further training needs while low costs of training needed for other jobs encourages occupational mobility of labour
- ➢ The health of the worker. Good health of the workers encourages geographical mobility as labour can easily adapt to different climate conditions while ill-health of a worker makes labour geographically immobile because of the need for continuous medical attention

- Age of the worker. Old age makes labour occupationally and geographically immobile since new skills are not easily adapted and labour has strong social ties while the youth are geographically mobile since they do not have strong family ties
- Degree of entry into an occupation/influence of trade unions and professional bodies. In some professions, trade unions or professional associations establish prerequisites for entering the industry. Newcomers must fulfil such licensing requirements in order to enter the industries. This reduces occupational mobility of labour. On the other hand, occupations with no entry restrictions to be fulfilled encourage occupational mobility of labour
- Social status for available jobs. A current job that confers status on a worker makes it difficult for the labour to move occupationally but labour is highly occupationally mobile when the current job is of low self-esteem
- Degree of fear of the unknown. Increased fear of the unknown makes labour geographically immobile
- The possibility of/prospects for promotion at the current job. If a worker's present occupation provides better promotion prospects or higher job satisfaction, his or her occupational mobility will be lower
- The climate conditions in other areas. Unfavourable climate conditions limit geographical mobility of labour while favourable climatic conditions encourage geographical mobility of labour
- The cost of living in other areas. Differences in the general cost of living between regions for example the high cost of renting property limits geographical mobility of labour
- The knowledge of the local language. Cultural and language barrier limit geographical mobility of labour while high level of knowledge of the local language encourages geographical mobility of labour
- The transport costs to other areas. The higher the transport costs, the lower the geographical mobility of labour. Better means of communication and transport encourages geographical mobility of labour

Explain the limitations to labour mobility in developing countries

Limitations of labour mobility in developing countries

- High wage paid in current job or area. High wage paid to a worker in the present occupation provides a higher income hence his or her occupational mobility will be lower
- Better working conditions in the current job or area. If a worker's present occupation provides better working conditions for higher job satisfaction, his or her occupational mobility will be lower
- The lack of information regarding other available jobs. Ignorance of labour about other jobs available elsewhere makes labour occupationally immobile
- High degree or level of specialization by labour. Some occupation require specialized skills and training. It would be difficult for new workers without such skills to enter such industries. Existing workers tend to be less willing to give up their present occupations. All these reduce occupational mobility of labour. Have specific skills that are not necessarily needed in growing industries which causes a mismatch between the skills on offer from the unemployment and those required by employers looking for workers
- The social or family ties. Strong family and social ties in form of home sickness limit occupational mobility of labour
- The social restrictions eg religious and cultural
- Political instability in areas where other jobs are in politically unstable region, workers tend to be more geographically mobile
- Lack of the required/appropriate skills for other jobs
- Long period of training needed for other jobs. Existing workers tend to be less willing to give up their present occupations. All this reduces occupational mobility of labour
- High cost of training needed for other jobs
- Poor health of the worker. Ill-health of a worker labour geographically immobile because of the need for continuous medical attention

- Old age of the worker
- Restricted entry into occupation/barriers by trade unions and professional bodies. In some professions, trade unions or professional association establish prerequisites for entering the industry. Newcomers must fulfil such licensing requirement in order to enter the industry. This reduces occupational mobility of labour
- Low social status for available jobs
- Fear of the unknown
- The prospects for promotion at the current job. If a worker's present occupation provides better promotion prospects or higher job satisfaction, his or her occupational mobility will be lower
- The unfavourable climate conditions in other areas
- The high cost of living in other areas. High cost of renting property limits geographical mobility of labour
- Language barrier
- The high transport costs to other areas. The higher the transport costs, the lower the geographical mobility of labour

Occupational immobility of labour

Occupational immobility of labour refers to the inability of labour to move from one job or occupation to another

Factors affecting Occupational mobility

- Monetary/non-monetary rewards
- ↑ income of the present job (higher opportunity cost in changing job) → mobility ↓
- Specialization of skills ↑ → mobility ↓
- Licensing requirements ↑ → mobility ↓
- Higher age of workers → mobility ↓

Causes of Occupational immobility of labour

- Limited skills for the alternative occupation
- Better working condition in the current occupation
- Better wages in the current occupation
- Social ties/social restrictions/discrimination in the labour market
- Poor health of the worker/limited natural ability
- Low esteem attached to the alternative occupations
- Expectation of promotion in the current occupation
- Lack of information about alternative jobs
- Stringent requirements for new jobs
- High costs of training for alternative jobs
- Long period of training required for the new jobs
- Old age as some workers are too old for new jobs

Geographical immobility of labour

This refers to the inability of labour to move from one geographical area to another

Causes of Geographical immobility of labour

- Political instability in areas of alternative jobs
- Old age of labour
- Fear of the unknown
- High transport costs to another location
- Poor health of labour
- Language barrier

- Unfavourable climate conditions in alternative places
- Social or family ties/strong attachment to the family
- Poor working conditions in the alternative location
- High costs of living in areas of alternative jobs
- Legalities like passports, visas, work permits etc, that limit geographical mobility of labour

Policies to improve the mobility of labour

To reduce occupation immobility;

- Invest in training schemes for the unemployed to boost their human capital to equip them with new skills and skills that can be transferred from one occupation to another
- Subsidise the provision of vocational training by private sector firms to raise the skills level for workers
- Advertise job opportunities
- Improve working conditions in alternative jobs
- Legislate a minimum wage (increase wages in alternative jobs) in order to encourage occupation mobility of labour and increased job satisfaction
- Provide unemployment benefits and employment transfer skills to reduce financial hardships and encourage workers to change jobs
- Create a job exchange centre to make it easy for people to know where jobs are
- Limit the activities of (relax barriers of) trade unions and professional bodies in order to overcome restrictions to entry in such occupations
- Fight the prejudices in alternative jobs

To reduce geographical immobility

The ways of increasing geographical immobility of labour in Uganda include;

- Advertise employment opportunities
- Infrastructural development
- Improve the political atmosphere
- Increase wages in areas with low wages
- Improve the health of the worker
- Improve working conditions in order areas
- Fight social prejudices
- Subsidise transport for workers/people moving into areas where there are shortages of labour – for example teachers and workers in the national health services

Importance of labour mobility

- Natural rate of unemployment. If labour is immobile, an economy is likely to face higher rates of structural unemployment. In a period of declining manufacturing employment, labour mobility is important for determining whether workers can relocate to newer jobs in the service sector
- Rapid technological change. Across the western world we have seen a decline in manufacturing employment levels. This is due to rising labour productivity, and outsourcing of production to lower labour cost economies. Protecting these jobs from the onset of technological change is to fight a losing battle. The real solution is to improve the ability of workers to relocate and find new jobs in the service sector
- Economic growth. High labour mobility may increase the productive capacity of the economy; it will be easier for firms expanding in new markets to attract qualified labour. Without labour mobility, innovation and expansion will meet supply constraints
- Demand for high wages. High degrees of immobility may put upward pressure on wages in labour markets where there is a shortage of labour. This could even lead to a wage-price spiral. Greater mobility enables a more competitive labour market

NB: Specificity of labour refers to the extent to which labour is restricted to a specialized purpose/use/to an occupation

SPECIALIZATION AND DIVISION OF LABOUR

Specialization is a practice where an individual/region/country concentrates resources in the production of a given commodity or service he/it can produce best and leave the rest of the activities to others (during a given time)

Whereas/while

Division of labour refers to the allocation of tasks among the workers such that each engages in tasks that he performs most efficiently

Or

The splitting of work among different stages in the production of a commodity with each stage manned by a different worker

Or

Is a situation where the production of a commodity is divided into a number of separate processes each of which is performed by a different worker (specialization by process)

Advantages of specialization and division of labour are thus;

- Increased workers skills and efficiency (experience). Specialization allows a person to gain more skills and become efficient while handling a task continuously
- Time saving. Working time and again on one job increases ones speed hence saving time during production
- Mass production/greater quantity of output, it encourages increased output. By producing and selling more volumes of goods a firm is able to earn more income and profits
- Exploitation of talents; continuous working on the same work allows a worker to exploit fully his/her talents
- Reduces fatigue/saves energy; as work is shared, a person does not easily get tired since he/she does not change from one task to another
- Specialization promotes trade through exchange
- Economy to tools ie tools are put to good use. The duplication of tools and task requires only one set of tools
- Enables greater use of machinery hence production of standardized goods
- Better quality goods are produced because of the use of experts in various tasks
- Employment creation. This is due to need for specialist at each stage of production
- Faster training of labour. Division of labour tends to reduce the period of training of labour hence low cost of production
- Encourages co-operation of workers. This is because of need for continuity in the production process that necessitates cooperation among workers at different stages of production

Disadvantages of specialization and division of labour

- It leads to boredom/monotony; this is due to doing the same work over and over again
- It leads to mass production which may result in surplus that can be put to waste due to lack of market
- It leads to exhaustion of resources. This is because specialization calls for over and exploitation of resources
- It leads to unemployment because of territorial specialization that leads to over dependence on one produce without market. Sometimes use of machines displace workers (technological unemployment)
- It leads to loss of craftsmanship; this is a result of decline in hands skills especially in craftsmanship
- Breakdown of process, in the absence of a skilled worker at one stage may affect the entire process, continuity requires his/her

- It leads to lack of responsibility because one job is completed by different workers. The workers may lose his sense of responsibility as he performs only a tiny part of the whole process
- It exposes workers to greater risks of occupational disease like back ache
- Division of labour tends to narrow the worker's outlook as there is very little scope for the exercise of intelligence

CAPITAL

This refer to any manmade stock of physical assets accumulated by the society or an individual and directed towards the production process

Or

The human-made goods which are used in the production of other goods. These include machinery, tools, and buildings. Its reward is interest

NB Capital has many meanings, including the financial capital raised to operate and expand a business. In much of economics, however, capital means goods that can helps produce other goods in the future, the result of investment. It refers to machines, roads, factories, schools, infrastructure, and office buildings which human have produced to create goods and services

Forms of capital

- Fixed capital – this includes machinery, factories, equipment, new technology, factories, building, computers, and other goods that are designed to increase the productive potential of the economy for future years. Nowadays, many consider computer software to be a form of fixed capital and it is counted as such in the national income and product accounts of the United States and other countries. This type of capital does not change due to the production of the good
- Working capital – this includes the stocks of finished and semi-finished goods that will be economically consumed in the near future or will be made into a finished consumer good in the near future. These are often called inventory. The phrase "working capital" has also been used to refer to liquid asset (money) needed for immediate expenses linked to the production process (to pay salaries, invoices, taxes, interests…) either way, the amount or nature of this type of capital usually changes during the production process
- Financial capital – this is simply the amount of money the initiator of the business has invested in it "financial capital" often refers to his or her net worth tied up in the business (assets minus liabilities) but the phrases often includes money borrowed from others
- Real capital – this is the stock of physical assets or producer goods used for further production, for example factory buildings, machinery, tools and equipment
- Social overhead capital – this is capital in form of basic infrastructure. It is owned collectively by the society and mainly provided by the state, for example roads, public schools, hospitals, libraries, leisure parks etc
- Private capital - this is capital owned by private units such as firms and households (individuals)
- Sunk or specialized capital – this is capital that cannot be put to any other/alternative use, that is, it performs a specific function, for example an ice factory, a locomotive engine etc
- Human capital – this refers to investment in labour to acquire the necessary skills and knowledge through education training and health improvement for further production of goods and services

SOURCES OF CAPITAL

To individuals

- Personal savings from individual income
- Inherited income/wealth
- Retained profits after a given trading period
- Loans from financial institutions
- Gifts and other transfer incomes4

To the government

- Taxation
- Selling treasury bills and bonds
- Loans and grants from bi-lateral and multi-lateral agencies
- Profits/retained earnings from ventures run by government
- Compulsory saving schemes, for example, social security fund (NSSF)

THE ROLE OF CAPITAL IN ECONOMIC DEVELOPMENT

The role of capital in economic development include

Positive role

- It increases efficiency and productivity of other factors of production especially labour. Modern physical capital raises the quality and quantity of output produced by a unit of labour in a given period of time
- It is a means of technical development and technological transformation. Modern physical capital makes it possible to change from primitive methods of production to advanced methods that are more efficient in the production process, for example the use of a tractor in agricultural production instead of the hand hoe
- It facilitates optimum use of resources hence full employment. Capital enables the efficient exploitation and utilization of idle/dormant/redundant domestic resources like land and minerals hence reducing excess capacity
- Facilitates research. Financial capital makes labour innovative and creative through facilitating the setting up of research/experimentation units which results into scientific and technological progress
- Promotes specialization in the production process. The injection of large amount of capital in a business encourages division of labour such that each individual carrier out a particular economic activity where they have the best skills and this leads to increased efficiency in production
- Facilitates trade and exchange and therefore commercial production. The use of capital in form of machines encourages mass production for the market leading to increased volume of both local and foreign trade
- Improves quality of final output. The use of modern physical capital enables the production of improved quality of goods and services that are competitive on the world market. Producers are able to earn higher profits which are an incentive for increased production
- Simplifies and quickens production process thus increased output. The use of modern physical capital reduces loss of production time in industrial firms by simplifying work. This helps in producing large volume of output in a short time leading to economic growth.
- Facilitates development of infrastructure. The use of capital in form of machines enables the undertaking of construction of roads, railway lines, power dams, hospital etc that foster further production of goods and services in the economy
- Acts as an engine of economic reforms. Capital enables economic transformation to take place in an economy, for example privatization programmes, and free primary and secondary programmes being implemented in Uganda are only possible with the use of capital
- Facilitates industrialization process. Abundant capital accelerates industrial development by enabling the setting up of manufacturing firms that produce output on a large scale
- Facilitates further capital accumulation. Capital in form of fixed assets is used as collateral security to acquire loans from financial institutions inorder to increase on the stock of capital goods

Negative role

- Promotes external resource dependence. Foreign capital in form of loans and machinery makes an economy to over rely on external resources to supplement on the domestic resources for her development which worsens her debt burden and causes loss of local initiative
- Leads to exhaustion of resources due to over exploitation. The use of machines in the exploitation of some resources leads to over use and eventual depletion
- Leads to income inequality. This is because those who have large capital are able to take on larger investments and accumulate more returns at the expense of other who are poor
- Leads to technological unemployment. The use of machines in production reduces on the size of the manual workers as most of the tasks are automated thus causing technological unemployment
- Promotes brain drain. The use of machines in production worsens the unemployment problem in the country forcing the unemployed individuals to search for greener pastures in foreign countries

CAPITAL ACCUMULATION/CAPITAL FORMATION

Capital accumulation is the process of devoting part of income to create capital stock

Or

Process of creating/building up capital stock through investment

Or

Capital accumulation is the process of building up the stock of producer goods through positive net investment

Or

Capital accumulation is the building up of the stock of man – made assets that help in the production of goods and services through positive net investments

FACTORS THAT DETERMINE/INFLUENCE/AFFECT THE LEVEL OF CAPITAL FORMATION IN UGANDA

An explanation of the factors that determine the level of capital formation in my country include;

- The level of income. The higher the level of income the greater the amount of savings in the economy which are channeled into more investments resulting into faster capital formation while low levels of income lead to low savings and investment resulting into low capital formation
- The level of savings. The higher the level of real savings, the greater the supply of loanable funds for investment leading to rapid increase of capital stock while low levels of savings reduce the amount of loanable funds leading to low capital formation
- The rate of inflation/the price stability. High rates of inflation lead to decline in the value of money which discourages savings and investment resulting in low levels of capital formation while low rates of inflation encourage savings and investment leading to faster capital formation
- The level of infrastructural development. A high level of development of social and economic infrastructure especially the banks enhances mobilization of savings and widens investment opportunities leading to greater capital formation while shortage of basic infrastructural facilities like power, bank, transport and communication etc. limits the scope for high investment leading to low capital formation
- Market size. An expansion of consumer demand both within and outside the country provides an incentive for investment and entrepreneurs find it profitable to set up ventures leading to faster capital formation while for a small market size private investment is not very profitable and incentives to invest are poor leading to low capital formation
- The level of entrepreneurship. Presence of honest and dynamic entrepreneurs who are able to take risks and bear uncertainties of production leads to increased investment of accumulated savings resulting in faster capital formation while acute shortage of efficient, dynamic and daring entrepreneurs who are capable of taking risk in business implies that savings of the people cannot be utilized in speculative activities thus failure to create further capital accumulation

- Investment climate in terms of taxation and other incentives/government policy on allocation of resources (investment). A favourable investment climate through provision of tax holidays, free land etc reduces the cost of doing business which encourages investment leading to faster capital formation while high taxes on income and profit hamper the incentive to make investment in the economy by increasing the cost of doing business resulting in low capital formation
- Political climate. A favourable political situation provides confidence for more investment leading to faster capital formation while political unrest creates fear among entrepreneurs which limits the scope of investment resulting in low capital formation
- Degree of accountability/rate of corruption. High levels of accountability (low levels of corruption) leads to greater investment due to proper use of funds resulting in faster capital formation while a low degree of accountability (high levels of corruption) leads to misuse of investment capital for personal interest thereby acting as a disincentive to investment resulting in low capital formation
- The existing stock of capital. An increase in the stock of existing capital encourages more investment leading to greater capital formation while a limited stock of existing capital leads to low levels of investment resulting in low capital formation
- The population growth rate. A low and stable population growth rate encourages more savings and investment resulting into faster capital formation while a high population growth rate leads to high consumption levels, low savings and low investment resulting in low capital formation
- The capital inflows and outflows. Foreign capital inflows widen the scope of investment by financing various business activities which leads to greater capital formation while excessive capital outflows in form of debt repayments, profit and income repatriation reduce the funds available for re-investment which results in low capital formation
- The state of technology/the techniques of production. High levels of technology encourage more resource use leading to greater investment and faster capital formation while use of poor technology reduces the level of resource exploitation leading to low investment levels and low capital formation
- Time preference. Individuals with a high rate of time preference are inclined towards current consumption over future consumption leading to low savings, low investment and low capital formation while individuals with a low rate of time preference value future consumption compared to current consumption leading to increased savings and investment resulting in faster rates of capital accumulation
- Degree of conservatism/cultural factors. Backward and traditional system based on superstition and speculation fail to develop a suitable environment for making favourable investment in the country leading to low capital formation while promotion of western values and beliefs increases the level of savings and widens the scope of investment leading to greater capital formation
- Level of interest rate on capital (loans) (and savings). High interest rates on loans adversely affect the marginal efficiency of capital which in turn discourage investment in the country leading to low capital formation while a low interest rate on loans encourages borrowing by reducing the cost of doing business which leads to high levels of investment and capital formation.

FACTORS THAT LIMIT CAPITAL ACCUMULATION IN THE DEVELOPING COUNTRIES

- Limited capital for investment/low levels of existing capital stock. A limited stock of existing capital leads to low levels of investment resulting in low capital formation
- Low savings. Low levels of savings reduce the amount of loanable funds leading to low capital formulation
- High population growth rates. A high population growth rate leads to high consumption levels, low savings and low investment resulting in low capital formation

- Insufficient investment incentives. A low degree of accountability (high levels of corruption) leads to misuse of investment capital for personal interests thereby acting as a disincentive to investment resulting in low capital formation
- Small market size. For a small market size private investment is not very profitable and invectives to invest are poor leading to low capital formation
- Limited entrepreneurial skills. A cute shortage of efficient, dynamic and daring entrepreneurs who are capable of taking risks in business implies that savings of the people cannot be utilized in speculative activities, thus failure to create further capital accumulation
- Under developed infrastructure. There is a low level of development of commercial banks and other financial infrastructure/instructions which limits the scope for high investment resulting in low capital formation
- High rates of inflation. High rates of inflation lead to decline in the value of money which discourages saving and investment resulting in low capital formation
- Poor political atmosphere. Political unrest creates fear among entrepreneurs which limits the scope of investment resulting in low capital formation
- Conservatism/cultural limitation. Backward and traditional systems based on superstition and speculation fails to develop a suitable environment for making favourable investment in the country leading to low capital formation
- Low incomes. Low levels of income due to poverty lead to savings and investment resulting in low capital formation
- High level of capital outflow. Excessive capital outflows in form of debt repayments, profit and income repatriation reduce the funds available for re-investment which results in low capital formation
- Poor production techniques. Use of poor technology reduces the level of resource exploitation leading to low investment levels and low capital formation
- High liquidity preference. This reduces the level of funds available for savings and investment
- High time preference/poor consumption habits/spend thrift. Individuals with a high rate of time preference are inclined towards current consumption over future consumption leading to low savings, low investment and low capital formation
- Low level of accountability. A low degree f accountability (high levels of corruption) leads to misuse of investment capital for personal interests thereby acting as a disincentive to investment resulting in low capital formation
- High interest rates on loans. High interest rates on loans adversely affect the marginal efficiency of capital which in turn discourages investment in the country leading to low capital formation
- Poor land tenure system. This makes it difficult to acquire land for investment purposes leading to low capital formation
- High levels of marginal propensity to import. Importation of large quantities of consumer goods that can easily be manufactured in the country is a great impediment to capital formation

Measures for increasing capital accumulation include

- Maintaining political stability
- Controlling population growth rate
- Expanding the size of market
- Fighting against cultural rigidities
- Increasing income levels in the economy
- Creating a favourable investment climate
- Improving on entrepreneurial skills
- Developing infrastructure
- Fighting against corruption so as to ensure accountability

- Maintaining price stability by reducing inflation
- Encouraging capital inflows
- Increasing on the existing stock of capital
- Providing credit facilities to investors
- Ensuring proper government allocation of resources

MOBILITY OF CAPITAL

Mobility of capital is the ease with which capital moves from one occupation or location to another

Or

Capital mobility is the ease with which capital can shift or move from one job (activity) to another or from one area to another

NB Productivity of capital is the amount of output that a unit of capital can produce in a given period

Factors that influence the mobility of capital in a market economy

- Level of specificity
- Possibility of movement
- Cost of transferring capital
- Bulkiness of capital
- Level of payment in alternative occupation/location
- Appropriateness in alternative use/location

Barriers/Limitations to mobility of capital

- High levels of specificity
- Fixed capital which is difficult or impossible to relocate
- Bulky or heavy capital that is difficult to move around
- High interest charged on capital borrowed/very high cost of relocating
- Inappropriate conditions in alternative use
- Low payment in alternative use/location or high income generated by capital in the current activity
- Poor infrastructure/high cost of transfer
- Inappropriate capital which cannot be used in the alternative activity or job

Causes of geographical immobility of capital

- Excessive weight of capital
- Inability to be moved for example inability to move factory buildings
- High costs involved in transporting capital to other locations
- Limited manpower to manpower it in alternative locations
- Low payment in alternative geographical locations
- Inappropriateness of capital in alternative locations for example tractors not being appropriate in swampy areas

Questions;

(a) Distinguish between capital formation and capital consumption

(b) Examine the factors that limit capital formation in your country

SOME KEY TERMS

Capital appreciation is the increase in value of capital assets or goods (over a given period of time)

Capital formation or accumulation is the process of creating a country's stock of capital

Or

The process of increasing a country's existing stock of producer goods

Investment is the process of devoting part of national (personal) income to the increasing of the existing stock of capital

Or

The process of devoting part of personal income to the production of capital goods

Investment incentives are offers or encouragements by the government to (foreign) investors to encourage them to invest in the country

Examples of investment incentives in your country

- Development of infrastructure
- Provision of security to persons and property/improving political climate
- Liberalization of the economy
- Tax relief
- Allocation of land for investment/undertaking land reforms

DEPRECIATION OF CAPITAL

Depreciation/capital consumption

This is the loss in the value of capital assets over a given period of time

Or

Is the wear and tear of capital assets in the production process

Capital consumption allowance refers to the amount of money set aside by an entrepreneur to cater for the wear and tear of capital assets of a firm

Example

Given that a country's stock of productive machinery is shs 200 billion at the start of the year 2009, the total output generated by the machinery during the same year was shs 800 billion, depreciation costs for the same period were 30%. Calculate

(i) Value of depreciation

Value of depreciation = depreciation costs x stock of productive machinery
= 30% x shs 200bn
Value of depreciation = shs 60bn

(ii) Net output during the year

Net output = total output – value of depreciation
= shs 800bn – 60bn
Net output during the year = shs 740bn

MARGINAL EFFICIENCY OF CAPITAL (ME_K)

This refers to the expected or anticipated monetary returns on an additional unit of capital invested/employed

Or

The ratio of the prospective monetary returns to the supply price of an additional unit of capital invested

Or

It refers to the yield expected from an additional unit of capital invested over its cost

Or

The expected quantity and quality of output that can be realized by employing an additional unit of capital

Determinant of marginal efficiency of capital in an economy

- Level of taxation/subsidization policies. Heavy taxation and low subsidies by the government discourages the consumption level of commodities thus decreasing the returns on investment leading to low marginal efficiency of capital
- Anticipated output. The larger the quantity of output expected to be produced by a firm, the greater the expected returns and hence high marginal efficiency of capital while reduced quantity of output expected leads to low returns thus low marginal efficiency of capital
- Rate of interest. This has an effect on the cost of capital. The lower the interest rate, the higher the marginal efficiency of capital and the higher the interest rate, the lower the marginal efficiency of capital

  Illustration

The lower the interest rate the higher the level of investment since capital is relatively cheaper while the higher the interest rate the lower the level of investment since capital is expensive to acquire

- Price levels/rate of inflation. Marginal efficiency of capital is high during periods of inflation or rising prices while low price levels lead to low profitability hence low marginal efficiency of capital
- Availability of co-operant factors (the size of the initial capital, the entrepreneurial ability, the land tenure system and the labour skills). A high quality and quantity (efficiency) of co-operant factors leads to high marginal efficiency of capital while shortage of co-operant factors leads to low marginal efficiency of capital
- Size of market. A big market size leads to increase in incomes, increase in aggregate demand and increased profitability resulting in high marginal efficiency of capital while a small market size leads to low levels of aggregate demand and low profitability resulting in low marginal efficiency of capital
- Depreciation rate. The higher the rate an cost of depreciation of capital, the lower the marginal efficiency of capital while the lower the rate of depreciation the higher the marginal efficiency of capital
- Level of technology/techniques of production. Higher levels of technology lead to higher levels of efficiency and productivity thus high returns and hence high marginal efficiency of capital while poor technology reduces the quantity and quality of output, therefore leading to low marginal efficiency of capital
- Available excess capital. The existence of excess capacity in a firm leads to increased investment hence high returns and thus high marginal efficiency of capital while a firm that has reached optimal capital cannot increase its scale of production resulting in low returns and a low marginal efficiency of capital
- The level of infrastructural development
- Number of firms in the industry

ENTREPRENEUSHIP AND ORGANISATION

Entrepreneurship

Consider entrepreneurship as a factor of production, leaving debate aside.

Entrepreneurship is a factor of production that makes decisions and undertakes the organization/coordination of other factors of production in the production process

In markets, entrepreneurs combine the other factors of production, land, labour, and capital, to make a profit. Often these entrepreneurs are seen as innovators, developing new ways to produce and new products. An entrepreneur is a person who undertakes the risk of initiating and financing a business with the major aim of making profits. The reward is profit

Organization

Organization refers to a group of skilled people whose responsible for the proper combination of other factors of production in the right proportions in order to produce a given amount of output, for example accountants, managers etc. the reward is salary

Functions or role of an entrepreneur in the development process

- Initiates and finances the business by injecting capital at all stages of production with the aim of making profits
- Employs other factors of production such as land, labour and capital and makes arrangements for rewarding them in form of rent, wages and interest respectively
- Monitors and organizes the entire production process to ensure that there is continuity in production of goods and services
- Bears all the risks or uncertainties involved in the production process, for example fall in demand for the products
- Undertakes the major production decisions concerning the business by providing answers to questions on what, when, low and for whom to produce

- Ensures co-ordination of other factors of production in proper combinations so as to reduce costs of production
- Undertakes all the inventions and innovations in the production process for the good running of the firm, for example discovery of new markets, new sources of raw materials, and new production techniques
- He looks for market for the products of the firm either domestically or internationally

Question: Explain the role of an entrepreneur in the economic development of your country

Factors that determine/affect/influence the supply of entrepreneurship

- Level of education and training
- Availability of capital and other economic resources
- Extent/size of the market
- Natural and acquired abilities
- Level of technology
- Level of economic development
- Political climate
- Level of income
- Socio-cultural factors such as religion, traditions etc
- Government policy in relation to investment

Causes of scarcity of entrepreneurs in developing countries include

- Shortage of capital
- Low levels of education and training
- Limited managerial and technical skills
- Unfavourable government policy in relation to investment
- Political instability
- Conservatism/socio-cultural tendencies
- Low levels of technology
- Poorly developed social and economic infrastructure
- Small size of market
- Predominance of peasant agriculture
- Deficiency of entrepreneurial talents and abilities
- Widespread poverty and income inequalities which lowers the levels of savings and capital formation
- Economic instability like inflation

Measures of improving the level of entrepreneurship in my country include

- Providing investment incentives like land allocation and tax holidays to entrepreneurs
- Encouraging trade liberalization
- Encouraging use of appropriate technology
- Undertaking further privatization
- Encouraging greater research into technology and management skills through entrepreneurship education
- Creating wide markets by joining regional groups
- Creating a positive attitude towards entrepreneurship
- Establishing social and economic infrastructure
- Ensuring a stable political climate

THE CONCEPT OF PROFITS

Profits of a firm are realized form the difference between the total revenue generated from the sale of output and the total costs used in the production of that output

Profits = Total revenue (TR) – Total cost (TC)

TYPES OF PROFITS

Normal profit refers to what an entrepreneur earns which is sufficient to maintain him in the present employment

It is a profit level earned by a firm where average revenue is equal to average cost (AR=AC)

OR

The reward to an entrepreneur that is just enough to cover the total costs so as to keep him in production without attracting other firms to join the industry

Pure/economic/supernormal/abnormal profit refers to the payment made to the entrepreneur for undertaking the risk of production

Or

It is profit earned by a firm where average revenue is greater than average cost

Or

The excess earnings of a firm over and above the normal profits that attract new firms to joint production

Net profit refers to the true economic profits that the firm remains with after subtracting all the expenses from the gross profit

Or

Net-profit is a residual payment to the entrepreneur

Sub-normal profit is any profit less than the normal profit where price is less than the average costs (AC) of production. The firm is making an economic loss but continues in production since it is covering the average variable costs (AVC)

Uses of profits in development

- Guides in resource allocation. Resources move from areas of low profits to areas of high profits
- Promotes re-investment, that is, aids, further expansion of the business through ploughing back of the profits
- Acts as a source of revenue inform of taxes. The government may impose a profit tax to generate revenue for recurrent and development expenditure
- Acts as a source of capital for the business. This can aid further expansion of the business
- Acts a reward to an entrepreneur for risks and uncertainties in production process/encourages entrepreneurs to undertake risks in investment
- Helps in financing research/stimulates inventions and innovations. This leads to discovery of new production techniques
- Used as a measure of efficiency in production. High profits indicate increased efficiency of the business while low profits indicate low efficiency of the business
- Used to reward other factors of production for example payment of rent and wages

Factors that influence/determine/affect the level of profits of a firm/an economy

- Price levels. Firms that charge high prices for their product(s) are able to generate high profits but firms chagrining a low price for their product(s) generate low profits
- Cost of production. An increase in costs of production in form of increase in labour costs, raw material costs and costs of rent etc leads to a decrease in profits while low costs of production incurred by a firm make the product more competitive leading to increase in profits
- Size of market or demand. If demand is high of a good or product which is fashionable, the firm is able to carve out strong brand loyalty. This increases the customer base leading to high profits. But for products that have failing demand the firm earns low profits
- Goal/objective of the firm. Not all firms are profit maximizing. Some firms may seek to increase market share, in which case profits will be sacrificed to gain market share. On the other hand, firms aiming at profit maximization restrict output and charge price prices leading to generation of high profits

- Entrepreneur skills or managerial ability. Successful management is important for the long-term growth and profitability of firms. Firms that are better organized/managed are able to properly utilize the factors of production leading to generation of high profits
- Conversely, poor management leads to decline in worker morale, which harms customer service and worker turnover and the firm may also suffer from taking wrong expansion plans. This leads to low profitability of the firm
- Number of firms or producers/level of competition. If a firm has monopoly power, it has little or no competition therefore, demand will be inelastic. This enables the firm to increase profits by increasing the prices

  But if entry is easy, then the firms face the threat of competition. If the market is competitive, the profits lower because consumers would only buy from the cheapest firms
- Degree of risks. Highly risky ventures like oil mining and exploration are highly profitable while less risky ventures are less profitable
- Level of output or supply. High output levels lead to generation of more profits while low output levels lead to earning to low profits
- Level of taxation. High tax rates increase the cost of doing business and reduce the level of profits while low tax rates reduce the cost of doing business leading to generation of high profits

Question: Examine the factors that influence the level of profits in your country

Factors that limit profit levels /Causes of low profits of firms in Uganda

- Small/limited market size
- High costs of production
- High price levels
- High levels of taxation
- Low degree of risks
- High general price levels
- Low level of output/supply
- Limited entrepreneurial skills
- High level of competition/many firms in the industry
- Sales revenue maximization objective of the producer

THE CONCEPT OF INTEREST

Interest is the monetary payment for use of capital as a factor of production

NB

Interest rate is the proportion of capital borrowed that must be paid to the lender in addition to the principle, as reward to capital as a factor of production

In simple terms, interest is the cost of borrowing and price of lending. It is calculated and paid at an agreed rate which is expressed as a percentage.

Determinants of interest rates in Uganda include

- Period of loan repayment
- Supply of liquid or investment capital
- Demand for loanable funds or investment capital
- Government in case of public businesses
- Money supply in the economy
- Economic situation
- Level of stability in the banking sector
- Policy of individual lender

Causes of high interest rates in Uganda

- Low level of savings/low supply of loanable funds

- High demand for loanable funds
- The greed for profits by financial institutions
- High risk of investment
- High interest rates on government borrowing/government security like treasury bills
- Few financial institutions in the country

Measures that should be taken to stabilize interest rates in Uganda

- Encourage savings
- Fight against inflation or stabilize prices in the country
- Stabilize the bank interest rates charged on commercial banks by Bank of Ugnada
- Promote the growth of the financial sector or commercial banks

RENT

This is the monetary payment for the use of land as a factor of production

Types of rent

1. Quasi rent refers to earnings to a factor of production above its supply price that are earned when a factor has relatively inelastic supply in the short run but elastic supply in the long run, for example, medical doctors, lawyers, engineers etc
   Or
   Payment to a factor of production in excess of its supply price because the factor is inelastic in supply in the short-run but elastic in supply in the long run
2. Commercial rent is the payment for the hire of a durable asset, for example, buildings, machinery, television etc
3. Site or location rent refers to payment to a factor due to its location, for example land in urban areas in highly paid for than in rural areas
4. Scarcity rent refers to payment to a factor of production due to its relative scarcity, for example land for building and construction in Kampala is scarce leading to high demand and high prices
5. Rent of entrepreneurship is the excess earnings that accrue to an entrepreneur that attract new firms into an industry
   Or
   Refers to the supernormal profits enjoyed by an entrepreneur when the average revenue is greater than the average cost
6. Economic rent is the income earned by a factor of production over and above its supply price or transfer earnings
   Or
   Is payment made to a factor of production which is excess of its transfer earnings
   Or
   Is the earning by a factor of production over and above the minimum earnings objectively required to keep that factor of production in its existing use
   Or
   Is the payment to a factor of production in excess of its supply price

NB: All payment for land is economic rent because

- Land is fixed in supply
- Land is a free gift of nature hence its supply price is zero
- Land is geographically and occupationally immobile in the short run

NB: Transfer earnings refer to the minimum reward necessary to keep/retain a factor of production in its present employment/occupation without transferring to the next best alternative use/employment

Example

Question 1: Given that a factor of production received Uganda Shs.10, 000 and its economic rent is two times its transfer earnings, calculate a factor's actual earnings.

Answers;

Actual earnings	=	transfer earnings + economic rent
	=	Shs10, 000 + (2 x Shs10, 000)
Actual earnings	=	Shs.30, 000

Question 2: The supply price of a factor of production is Shs 200,000 and the actual earnings are shs 800,000, determine the economic rent

Economic rent	=	actual earnings – transfer earnings
	=	Shs.800, 000 – shs.200, 000
Economic rent	=	Shs.600, 000

FACTORS INFLUENCING THE LEVEL OF ECONOMIC RENT

- The demand for a factor of production
- The level of supply of a factor of production
- The degree of specificity or mobility of a factor of production
- The elasticity of supply of a factor of production
- The elasticity of demand for a factor of production
- The degree of substitutability of a factor of production
- Location of the factor
- Time period
- The natural ability or talent
- The differentiation of the factor
- The earning by the factor
- The existence of monopoly price discrimination

THE DEMAND FOR FACTORS OF PRODUCTION

- The cost of price of the factor
- The degree of substitutability of a factor
- The marginal productivity of the factor
- The demand for the final product produced by a factor
- The complementarity of a factor. The availability and quality of the co-operant factors
- The government policy of taxation and subsidization
- The specificity of a factor
- The amount of a factor required in production

Factors determining elasticity of supply of a factor of production include

- Elasticity of factor substitution
- Elasticity of demand for a final product
- Ratio of factor cost to total costs of production
- Elasticity of supply of other factors of production

Factors that influence the supply price of a factor of production include

- The elasticity of supply of the factor
- The elasticity of demand for a factor
- The productivity of the factor
- The availability and quality of the co-operant factor
- The demand for a factor

FACTOR MOBILITY
This is the ease with which a factor of production can move from one occupation or geographical area to another
There are two main types of factor mobility, occupation and geographical mobility

Geographical mobility of a factor is the ease with which a factor moves from one location to another
While
Occupational mobility of a factor is the ease with which a factor moves from one form of employment/occupation to another
FACTORS THAT AFFECT FACTOR MOBILITY IN AN ECONOMY
- Job specification eg skills, religion, gender, age etc
- The influence of trade unions and professional bodies
- The cost and period of training
- The age of workers
- Level of advertising of available jobs in the labour market/level of awareness about suitable jobs
- Political climate/atmosphere
- Prospects of promotion on the job
- Level of remuneration/wages
- Nature of a factor of production eg land
- Level of working condition in alternative jobs/occupation/areas
- Level of specificity of factors of production/level of specialization of factors of production
- Social status in case of labour
- Social ties
- Health of the workers/labour

FACTOR IMMOBILITY
This is the inability of a factor of production to move from one occupation or geographical area to another
There are two main types of factor immobility, occupational and geographical immobility occupational immobility
Occupational immobility occurs when there are barriers to the mobility of factors of production between different sectors of the economy leading to these factors remaining unemployed, or being used in ways that are not efficient
Geographical immobility
Geographical immobility refers to the inability of a factor of production to move from one geographical area to another
It occurs when there are barriers to people moving from one area to another to find work
BARRIERS TO FACTOR MOBILITY IN UGANDA
- Impossible to move because of the fixed nature of the factor, for example, land, buildings etc
- Ignorance of other job opportunities available
- High degree of specificity of a factor of production
- Social status in the case of labour
- Political instability in areas of alternative jobs
- Low payment in alternative uses
- High cost of training or transfer to another occupation or location
- Poor health
- Long period of training for an alternative occupation
- Social ties
- Fear of the unknown

- Worse or inappropriate conditions in alternative locations or occupation
- Lack of appropriate job specifications, for example, skills, age, religion, gender etc
- Barriers by trade unions and professional bodies
- Old age

SUB TOPIC: BUSINESS UNITS AND THEIR OWNERSHIP

Sole proprietorship is a one main business in terms of ownership, source of capital, management, and fate of profits, burden of losses and other obligations

Advantages of sole proprietorship

- Easy to start due to limited capital required and simple formalities to be complied with. This type of business need not be registered
- Takes all profits alone. The owner knows that he is the one who will benefit from his hard work
- Gives a lot of independence as a sole trader in his own boss and undertakes personal initiative which increases efficiency
- Quick decision making since he is accountable to himself. Decisions can be made and put into effect immediately since there is no need for consultation
- It is flexible. It is easy to change from one line of business to another
- Has personal contact with customers because of the small size of the business, for example, may give credit to trustworthy customers
- Private business records hence confidentiality

Disadvantages of sole proprietorship

- Limited capital hence limited expansion
- Small scale operation, hence no economies of scale
- Unlimited liability. There is no body with whom losses can be shared so if the business fails, the proprietor has to bear the burden himself
- Overstrains/overworks himself
- Absence of owner due to sickness or death adversely affects the business
- Limited experience and lack of specialization

Problems faced by sole proprietors in Uganda

The following are the problems faced by sole proprietors in Uganda

- Control and organization are done by one person which over burdens the owner
- Difficult to expand due to limited capital
- Limited entrepreneurship skills/managerial skills
- Limited market
- High taxes which reduce their profits
- Poor decision-making which results into losses
- Bears the burden of business risks/losses alone
- Uncertainties/lack of continuity as life span of the business depends on the owner
- High competition
- Inadequate security to get bank loans
- Unlimited liabilities
- It is not a legal entity, that is, business is not recognized by law as a separate entity from the owner

TYPES OF PARTNERSHIPS

1. **ORDINARY PARTNERSHIPS.** This is one where the liability of the partners is unlimited and the minimum number of partners is 2 and the maximum is 20. In most cases the partners have equal rights and responsibilities. A partner stands to lose all his or her money contributed as capital should the firm make losses. In case a firm has insufficient money to pay the debts, partners' personal property is sold off in order to raise money to clear the debts

2. **LIMITED PARTNERSHIPS.** A limited partnership is one in which at least one partner in the firm enjoys limited liability. It is not a common form of partnership because in most cases people prefer to invest in private limited companies instead of limited partnerships
3. **TEMPORARY PARTNERSHIPS.** This is formed to perform certain activities within a stipulated period of time and it is dissolved as soon as the purpose for which it was formed has been completed or achieved. For example, a partnership can be formed by two construction firms to build a power dam for three years and it is dissolved as soon as the work is completed
4. **PROFESSIONAL PARTNERSHIP;** This is a partnership which is formed to render professional services and has a minimum of two and a maximum fifty partners, examples includes, professional partnerships formed by medical doctors, lawyers, auditors, tax consultants, teachers, engineers
5. **PERMANENT PARTNERSHIPS**

The types of partners include the following

(i) Active partner is a partner who in addition to providing capital and sharing profits and losses, plays an active role in the affairs of the business
(ii) Dormant/sleeping/silent partner, is a partner who contributes towards capital, shares profits and losses and is equally responsible for the debts of the firms, but he takes no part in running of the business
(iii) Limited partner, is a person whose liability towards the debts incurred by the business is limited to a stated sum, usually the capital contributed by him
(iv) A general partner, is a partner with unlimited liability and may be called upon to meet the firm's debts from his personal resources if the firm fails to settle them
(v) A major partner, is a partner who is above 18 years of age and his liability towards the business debts is unlimited
(vi) Minor partner is a partner who is below 18 years of age. He is not liable for the firms' debts beyond his capital
(vii) Quasi partner, is a person who does not contribute any capital or take part in the business but allows the firm to use his name
(viii) Real partner, is a partner who contributes capital and takes part in the running of the business

ADVANTAGES OF PARTNERSHIP

1. More capital can be raised/pooling of resources is possible. Partners are in a better position to raise more capital than sole traders due to their large number. It is possible for twenty partners to raise more capital than a single trade and this enables partners to expand the business
2. There is greater combination of skills and talents by partners/division of labour is promoted. Wider experience is brought in business by the different partners who carry out different tasks. For example if it is a partnership of three medical doctors, one can be an optician, the second a surgeon and the third a dentist
3. Better decisions are made due to regular consultations among partners. The partners consult one another before taking decisions. This reduces the possibility of making wrong decisions since two heads are better than one. Decisions are taken after all the partners have agreed or consented
4. Business losses and risks are shared among the partners. In a partnership, losses are shared among the partners in agreed proportions outlined in the partnership deed or the partnership act of 1890. The burden of losses is not shared by one person unlike in a sole proprietorship
5. There are lower costs of formation/formation of business is fairly simple. Partnerships are less costly to form compared to joint stock companies. The partners only need to get a certificate of registration from the registrar of business names. This makes the process of formation to be cheap and easy
6. Partnerships enjoy greater economies of scale than sole proprietorship. They can afford to operate on large scale because of their wider capital base. As a result of this, they enjoy the advantages of large

scale business operation such as getting discounts on bulk purchases, employing skilled labour, using modern machines in production etc

7. There is a possibility of inviting more partners if if the maximum number is not yet attained. The new partners bring in new ideas and more capital in the business that enables it to expand
8. In case of limited partnerships, there is limited liability for the limited partners. The advantage is that personal property of a limited partner is not sold off to pay the debts of the partnership. A limited partner only loses the amount of money contributed as capital when a firm is settling its debts
9. The business can easily expand by acquiring loans from lending banks. This is possible because partnership firms have collateral security to present the banks in order to access loans
10. In case of disagreement among partners, mutual discussion are held in order to come up with a solution. Partners are able to refer to a partnership deed in order to solve the misunderstandings among themselves
11. The business enjoys financial secrecy since partnerships are not compelled to publish their books of accounts to the public. The financial affairs of the business are not exposed to competitors

DISADVANTAGES OF PARTNERSHIP

1. Unlimited liability of partners. For general partnerships, the liability of partners is unlimited. This means that personal property of partners can be sold to raise money to pay the debts of the firm if their capital contributions are not enough to clear the debts of the firm
2. A wrong decision by one partner binds all the other partners. In case one partner makes a mistake such as buying defective or expired goods, all the partners suffer the consequences of this action (mistake) committed by one of them
3. Disagreements are bound to occur among the partners. The views of some partners may not be accepted by other partners. This brings about disagreements among partners and the progress of the firm may be hindered
4. Partners are discouraged by the sharing of profits/the incentive to work hard is reduced since profits are shared among partners. Some hard-working partners get discouraged when the profits that arise out of their effects are shared with the less hard-working partners. This lowers their morale and enthusiasm at work
5. Partnerships lack continuity. The death of one partner results into dissolution of the partnership. A new partnership with new provisions has to be formed after the death of one of the partners
6. There are delays in decision making. Decisions always take long to be made because each partner has to be consulted. This makes the firm to miss those immediate business opportunities that require quick action and decision eg the partners may delay to decide on whether to buy new machines and by the time they take a decision the cost of the machines has increased
7. Partnerships raise less capital than joint stock companies. The capital in a partnership is raised by few partners who may not be in position to raise large sums of capital when compared to that raised by shareholders in public limited companies eg a professional partnership with only 50 (fifty) partners raises less capital than a public limited company that has 1,000,000 (one million) shareholders
8. There are chances of admitting incompetent partners who may damage the good name of the firm. This arises where new partners are admitted basing on their capital contributions without considering their business knowledge and special abilities

Advantages of a partnership over sole proprietorship

- A partnership raises more capital than sole proprietorship
- The partnership can have a better combination of talent which is not a case of sole trade
- The burden of losses/liabilities is distributed to all partners unlike in sole trade
- The work is divided among partners due to specialization and division of labour which reduces work load of a partner unlike in sole proprietorship

- Partnerships have a better change of acquiring a loan than a sole proprietor since it has more assets
- The partnership business can easily be expanded because of admission of more partners unlike in sole trade
- Shared decision-making results into better decisions in a partnership unlike a sole trader who may make poor decisions
- The absence of a partner does not stop a partnership from operation but once a sole trader or proprietor is away the business will come to a standstill
- In case of limited partnership, the partners have limited liabilities unlike a sole proprietor who has unlimited liabilities

JOINT STOCK COMPANIES

A joint stock company is a corporate association of persons formed to carry out certain specific functions with a main aim of making profits. It is referred to as a joint stock company because individuals combine their capital to form the business. Individuals who own shares in a company become shareholders. The shareholders are the owners of a company

The common features of a joint stock company

- A separate entity, that is has an entity of its own separate from the owners
- Has perpetual continuity
- Has share capital divided into shares
- Members have limited liability
- A legal entity that can own property, sue and performs specified functions by law, that is, a corporate body

PUBLIC LIMITED COMPANIES

A public limited company is one with a minimum number of 7(seven) shareholders. There is no limit to the maximum number of shareholders in a public limited company and its shares are freely transferable. Some of the public companies whose shares have been listed on the Uganda Securities Exchange (USE) include; Uganda clays (U) Ltd, Stanbic bank Ltd, B.A.T (U) Ltd, DFCU Ltd, Centenary Bank Ltd, National insurance company Ltd, Bank of Baroda, Kenya Commercial Bank etc

Characteristics of a public limited company

1. It has a minimum number of 7 shareholders and a maximum number of shareholders which is not specified
2. It has an entity separate from its shareholders
3. The company's capital is divided into small units each called a share
4. A public limited company is allowed to publish or advertise its shares by issuing a document called a Prospectus ie it sells its shares to the public
5. Its shares are freely transferable. A shareholder who wants to sell his shares does not need to ask other shareholders for approval. He simply offers his shares to the stock exchange market for other interested people to buy them
6. Shareholders have no direct contact with employees or directors of the company. The affairs of the company are conducted by people appointed and elected by shareholders and these are called Directors of the company
7. The public limited company is a voluntary association ie shareholders are not forced to buy shares in a company
8. The liability of shareholders is limited ie the liability towards the debts of the company stops at the capital contributed by the shareholders (face value of shares)

Advantages of public limited companies

1. Shareholders in a public company have limited liability ie their personal property or assets are not affected by debts of the company. In the event of debts, what they stand to lose in only the capital contribution
2. Shares are freely transferable. Any shareholder wishing to sell his or her shares can do so without seeking permission from other shareholders. A shareholder simply sells the shares to another person through the stock exchange market incase his company is a quoted company

   NB

   (i) A quoted company is one whose shares have been floated on the stock exchange market so that they can be sold and bought

   (ii) Stock exchange is a market where already issued shares are bought and sold
3. A public limited company is able to get great amount of capital because of having many shareholders and it has authority to appeal to the public to buy its shares
4. A public limited company is required by law to prepare and publish its books of accounts. This enables shareholders to be informed of the financial performance of their company. They are able to know whether their company is making profits or losses
5. Public limited companies are in a better position to access credit for business expansion. This is made possible because they have adequate collateral security in form of fixed assets which they use to secure loans from financial institutions
6. Public limited companies enjoy economies of scale because they operate on large scale. As they operate on large scale, their average costs of production decrease or fall

   N.B Economies of scale are those advantages which are enjoyed by a business enterprise as a result of operating on large scale
7. A public limited company has assured or guaranteed continuity ie the death or withdraw of some shareholders does not affect its operation or continuity because the management of the company is entrusted (in the hands of) appointed directors
8. Public limited companies can obtain quotation on the stock exchange market on the condition that they have good financial history. This helps them to raise more capital easily by floating shares on the stock exchange

   It also makes investment in shares more meaningful hence attracting more share holders
9. A public limited company offers a variety of shares to suit different investment habits or needs of the public. It offers ordinary shares, preference shares, cumulative preference shares, non-cumulative preference shares. An individual is given an opportunity to choose which type of shares to buy or invest in

Disadvantages of public limited companies

1. Formation of a public limited company is a lengthy, tedious and expensive procedure ie a lot of money is required in its formation, the procedures in formation take a long time and many documents are required
2. Management of the company is in hands of an elected board of directors and these directors may have their own interests which conflicts with the interest of shareholders. This creates disagreements in the running of the company which may lead to poor performance of a public limited company
3. If a public company grows extensively large. It suffers from diseconomies of scale. Such diseconomies include rising average costs of production, complications in supervision of workers, increased costs of advertising, embezzlement of funds by the manager, poor communication between manager and employees etc all these may under mine the efficiency of public limited companies
4. In a public limited company, there is no secrecy or confidentially regarding business affairs. This is because a public limited company is required by law to prepare and publish its business accounts.

Therefore, many people get to know about the financial position of the company even when they are not shareholders

5. In a public limited company shareholder may not develop the personal desire or initiative to make their company to perform better. Lack of personal initiative by shareholders is created because there is no individual responsibility. Shareholders develop a feeling of "this is not my company; it belongs to all shareholders". As a result of this they become less creative. This results into inefficiency and slow growth of a public limited company

PRIVATE LIMITED COMPANIES

A private limited company is joint stock enterprise with a minimum of two (2) shareholders and a maximum number of fifty (50) shareholders excluding present and past employees. Examples of prominent private companies in Uganda include private companies under the madhvani group, Mukwano group of companies, companies under spear motors group etc

In most cases, private limited liability companies are set up as family business enterprises where the shareholders and directors are family members. Since it is a family business enterprise, people outside the family are not invited to become shareholders

Features of private limited companies

1. It has a minimum number of two (2) shareholders and maximum of fifty (50) shareholders excluding employees of the company
2. Its shares are not freely transferable ie a shareholder wishing to sell his/her shares must first seek permission from the directors or other shareholders
3. It can commence business activities as soon as it gets a certificate of incorporation
4. It is not required by law to publish its book of accounts to the public ie it is not required by law to prepare and publicize its income statement and balance sheet in the gazette or newspapers
5. Its share capital is divided into small uniform units called shares
6. Shareholders enjoy limited liability. The liability of the shareholders towards the debts of a company does not extend beyond the face value of shares one has in a company
7. It does not advertise its shares to the public for subscription. The companies Act does not allow a private company to appeal to the general public to buy its shares

Advantages of private limited company or companies

1. There is a high degree of independence. A private company is free from legal restrictions which apply to public limited companies eg it is not required to publish its books of accounts in the national Gazette and in newspapers
2. More capital is raised with the large number of shareholders than in the case of a sole trade or a partnership
3. All shareholders in a private limited company enjoy limited liability unlike in sole trade and partnerships where the liability of sole traders and partners is unlimited
4. The death, bankruptcy or withdrawal of any one shareholder cannot affect the existence of the business
5. It can afford to employ specialists like business managers, procurement officers, accountants, auditors, marketing experts etc due to its large capital base
6. Specialization and division of labour can easily be exploited in a private company unlike in a sole trading business
7. Promoters of a private company are able to keep control of their business in their hands by retaining the majority of shares unlike in a public company where directors are the ones who take decisions to run activities of a company
8. It can commence her business activities immediately after securing a certificate of incorporation unlike a public limited company that has to wait for a certificate of trading. This enables a private company to

take advantage of the immediate and profitable business opportunities as soon as it gets a certificate of incorporation

9. There is a possibility of issuing different types of shares to suit the investment habits of the shareholders

Disadvantages of private limited company

1. It cannot appeal to the public to buy shares because law prohibits it from issuing a prospectus This limits the company's ability to raise capital for expansion
2. Shares of private limited company are not easily transferred because private limited company cannot raise capital from more than 50 members
3. A private limited company may fail to take advantage of benefits of large scale activities as compared to private limited companies because of its limited company structure
4. Since there is no compulsory publishing of books of accounts, the sense of financial discipline and accountability is undermined

SOME KEY CONCEPTS

Money market

Money market is one in which short term financial assets/securities are exchanged

Features of money markets in developing countries

- They are mainly urban based
- They charge mainly high interest rates
- Mainly run on small scale
- There are few participants in the market
- They deal in limited variety of financial assets/instruments

Capital market

Capital market is one where long-term securities are traded

Functions of capital market

- Mobilization of savings
- To encourage investment
- Regulate the price of financial assets
- Promote ease of convertibility of assets for example for near cash to cash

Read about shares

THEORY OF THE FIRM

Distinction between a firm and an industry

A firm is a single unit of production under unified control and management

Or

Is a production unit that employs factors of production to produce goods and services

While

An industry is a collection of firms producing related products, for example the bread industry, beer industry, sugar industry etc

Factors that determine the firm's production decisions

- Facilities and organization. An entrepreneur produces a product for which he/she has the required facilities than one that he/she lack facilities
- Cost of production. One produces a product with lower cost than one with high cost
- Sales potential. Products with higher sales are produced compared to those with low sales
- Money requirements. One produces a product that required less money than one with more money requirements to reduce costs

- ➢ Labour requirements. Products with less labour requirements are produced than those that require more labour
- ➢ Supply sources. Entrepreneurs produce product that use accessible resources than those with scarce resources
- ➢ Transportation. One produces a product that is easy to transport than those that are complicated to transport.
- ➢ Acceptance by community. Products that are socially accepted are produced than that are illegal
- ➢ Legal requirements. One produces a produces a product that has less legal requirements and produces than one with more requirements
- ➢ The resources available

Objectives of a firm

A firm may aim at attainment of any use of the following goals

- ➢ To maximize output
- ➢ To maximize sales-revenue
- ➢ To maximize profits
- ➢ To capture and maintain a wide market share
- ➢ For long run survival of the business of firm

SUB TOPIC: SCALE OF PRODUCTION

Scale of production is set by the size of plant, the number of plants installed and the technique of production adopted by the producer

The business sector in Uganda is mainly dominated by small scale firms, with few medium scale plants and very few large-scale establishments

SMALL SCALE FIRMS

Small scale firms are those that operate with small sized plants, low employment and hence small output capacity. They are basically production units engaged in processing, manufacturing, assembling and servicing activities. Examples of small-scale industries are maize milling, bakeries, carpentry workshops, garages, brick laying etc

Features of small-scale firms

- ➢ Mostly use local inputs and raw materials
- ➢ Mainly serve small markets
- ➢ Mainly owned by the indigenous people/local citizens
- ➢ Mainly engage in small capital investment
- ➢ They are mainly labour intensive
- ➢ Mainly produce at excess capacity
- ➢ Mainly produce durable consumer goods
- ➢ Mainly small sized plants with low output level
- ➢ Mainly require little capital for establishment and maintenance
- ➢ They are mainly geographically dispersed/scattered throughout the country
- ➢ They mostly employ semi-skilled and unskilled labour

REASONS FOR THE PREDOMINANCE OF SMALL-SCALE FIRMS IN AN ECONOMY

Question: Why do small scale firms exist alongside large scale firms in your country?

- ➢ Poor infrastructure like poor roads and poor energy facilities tend to increase the cost of production thus making it difficult for firms to transport raw materials. Therefore, they are not able to increase their output because of the high costs of transporting raw materials
- ➢ Limited capital for expansion. Some of the small firms do not have enough capital to buy raw materials to increases their output hence they are forced to remain small

- Fear of diseconomies of scale. Some firms remain small for fear of the increased average cost of production associated with operation on a large scale, for example failure to supervise and control workers by management due to over-expansion
- Limited skilled labour. Many of these firms employ unskilled labour leading to low levels of efficiency and productivity thereby discouraging firms from expanding
- Limited supply of raw materials because of unfavourable natural factors forcing these firms to remain small in case of agro-based industries
- Limited markets. Due to the small size of the market, small firms are discouraged to increase their output for fear of making losses hence remaining small
- Poor techniques of production. These increase the cost of production making it difficult for firms to expand because they fear to make losses
- Fear of high risks and uncertainties. Some firms remain small because of the increased risks associated with large scale production like fall in demand for the products, losses etc
- Choice of the entrepreneur/objective of the firm. Many of the owners of small firms desire their independence. They have no ambitions to expand because they do not want to loss their control
- Market requiring personal touch. Some of the services dealt in require the owner's personal touch/contact, for example, hair salons, medical clinics, law firms etc
- Limited entrepreneurial ability. Some of the owners of these small firms do not have the skills to run and manage the large firms thus prefer to remain small
- Poor political climate. Some firms remain small because of the political unrest in some parts of the country which dents the confidence of the investors. They are scared about their life and property and would prefer to operate on a small scale to avoid making big losses
- Limited space for growth/poor land tenure system. Some firms remain small because they do not have enough land to enable them to expand
- Fear of increasing corporation taxes makes the small firms remain small because they do not want to incur those taxes which increases the cost of production and reduce profits
- Some firms remain small because they are in their early stages of development and they have not raised enough time to expand, for instance, they have not raised enough capital to buy more land so as to expand
- Some of the small-scale firms are used as pilot projects. So, they tend to operate on a small scale so as to attain high levels of efficiency. Since they are on a small scale, they are easily supervised, monitored and evaluated

EFFECTS OF SMALL-SCALE FIRMS IN DEVELOPING COUNTRIES

Positive effects of small-scale firms

- Lead to increased employment opportunities since they are labour intensive. As small-scale industries develop, they create more jobs to both the trained and casual workers. Such people earn income which enables them to buy the basic necessities of life and improve their standard of living
- Promote fair distribution of income because they employ many people. Small scale industries widen economic activities from which people generate income. As people earn income, the extent of income inequality is reduced
- To some extent, they promote self-sufficiency since they use local resources hence no need for importation of resources and also by producing a variety of goods for the local markets, small industries help to reduce dependence on foreign economies
- Lead to improvement in balance of payment position because they use local inputs hence a reduction in importation. They save foreign exchange which would have been spent on imports. This helps to reduce B.O.P problem to some extent since expenditure on imports is reduced

- Leads to exploitation of the would-be idle resources leading to increased output. They lead to the utilization of resources which would have remained idle. As resources get utilized, wastage of such resources is avoided, for example some small-scale industries recycle scrap metals into useful products thereby avoiding wastage of that vital resource
- Facilitate development of infrastructure, for example, roads are constructed to enable the movement of raw materials and final goods. The setting up of small-scale industries in particular areas calls for the development of supporting infrastructures in form of better road network, warehousing facilities and commercial banking facilities
- Act as a source of government revenue through taxation in form of corporate taxes. Government generates substantial tax revenue and license fee from small scale industries. This revenue is used by government to finance her development programmes
- Provide a wide variety of goods due to competition thus widening consumer choices. Since small scale industries produce a variety of products, consumers' choice is widened and this leads to improved standard of living for the local people
- Promote acquisition of skills as people employed learn to use machines and repair them. They provide on the job training programmes for the workers. For example, many local technicians are trained on the job in small scale industries where they acquire skills of working in even bigger industries
- Lead to increased incomes due to the provision of employment to people
- Provide cheap goods and services thus improving people's standard of living. By using locally available materials inputs, small scale industries produce relatively cheap commodities which can be afforded by the majority of the people. This helps to improve people's standards of living
- Promote creation of forward and backward linkages leading to more investment and employment. When industries are set up in an area, they induce the setting up of new firms to provide raw materials to those already existing industries (back-ward linkage). At the same time, new firms also emerge such that they creating market for products and by-products of the industries (forward linkage)
- Act as grounds for technological development. They are grounds for development of local technology. Small scale industries produce small machines like coffee graining mills. Through research, these machines are improved upon
- Promote further industrialization of the economy as more industries are set up because of backward and forward linkages. Therefore, they enable a country to diversity from agricultural to industrial production
- They serve as a training ground for entrepreneurs. Some entrepreneurs learn the skills managing industries from small scale industries. In the long run, entrepreneurs acquire management skills which they can later use to manage medium and large-scale industries
- There is increased output/they increase levels of GDP. Small scale industries lead to production of more goods which results into higher national income figure/GDP

Negative effects of small-scale firms

- Lead to wastage of resources because of unnecessary competition and duplication of activities. Many small-scale industries are competing for the same resources/inputs and this leads to irrational use of such resources in the long run
- Lead to limited contribution to employment since they employ few people. During their infant stages, small scale industries do not employ many people and therefore they contribute less to reducing unemployment in the country
- Lead to underutilization of resources since they produce small output. This arises from poor methods of production. At the same time, small scale industries serve as a small market which eventually makes them to produce at below their installed capacity making resources to be under-utilized

- Lead to pollution of the environment because small scale industries emit fumes. Pollution of the environment as a result of poor disposal of industrial waste
- Congestion in urban and semi urban areas. They are mainly concentrated in such areas and this causes regional imbalance in the distribution of economic activities
- Promote growth of slums since they are mostly established in urban areas. Many people move from rural areas to go to urban areas to look for jobs leading to the development of slums. They lead to growth of slums in urban and semi-urban areas where they are mainly concentrated. This leads to social evils like high crime rate in urban areas where those industries are located
- Production of low/poor quality goods. This arises from use of poor techniques of production, use of low-quality inputs and failure to abide by quality specifications. This has reduced market for products of small-scale industries
- They contribute less or low revenue to government. Since they operate on small scale the government gets low tax revenue from them ie small scale industries are not major or significant sources of tax revenue to the government

PROBLEMS FACED BY SMALL SCALE FIRMS IN UGANDA

The major challenges impending the developing of small-scale firms in Uganda include

- Limited capital. There is limited capital due to low incomes and profits and the limited access to loans by small scale industrialists. This discourages the buying of equipment and machinery for development of small-scale firms
- Limited markets. There are limited markets for the products of the small-scale firms both at home due to low incomes and abroad due to their poor quality. This leads to low sales and thereby resulting into wastage of goods or resources and this limits growth of small-scale firms
- Underdevelopment infrastructure. Infrastructure such as roads, rails and power plants are in a poor state. This limit effective movement of raw materials and finished products from one place to another and this limits growth of small-scale firms
- Limited skilled labour. The efficiency of small-scale firms is limited by use of mainly unskilled and semi-skilled labour due to the poor education system. This limits labour productivity and labour efficiency which results into low quality and quantity of output produced hence limiting growth of small-scale firms
- Poor technology. This is mainly due to use of labour intensive techniques of production and importation of unsuitable technology for production which results into production of poor-quality industrial products thereby discouraging growth of small-scale firms
- Political turmoil. This scares away local investors because of fear of losing their lives and property thereby discouraging growth of small-scale firms
- Limited entrepreneurial abilities. This leads to poor management/high level of inefficiency in the industrial sector thus limiting industrial development
- Inadequate raw materials to be used for the production of various industrial products because of poor performance of the agricultural sector that is the main source of raw materials for small scale agro based processing industries.
- Unfavourable tax levels. This leads to high costs of production in the small-scale firms and stagnation in the growth of some firms thereby limiting growth of small-scale firms
- Stiff competition from foreign goods. Thus, further limits that market for locally products that cannot compete with the superior foreign products, thereby limiting growth of small-scale firms
- High cost of doing business due to high rates of inflation. This has resulted in the closure of some small-scale firms and stagnation in the growth of others
- Unfavourable land tenure system. This limits access to land resources for the growth of small-scale firms

MEASURES TAKEN TO SUPPORT SMALL SCLE FIRMS IN UGANDA
ACCEPTABLE TENSE: IS/HAS

- Development of infrastructure, for example roads and power. This is to improve on the transportation of the raw materials and finished products of the small-scale firms which encourages investors to establish more firms and expand existing ones
- Provision of investment incentives for example tax and other incentives to small scale industrialists. This is aimed at improvement of investment climate by providing tax holidays and tax rebates. This is helping to reduce the cost of doing business in the country and is encouraging investors to set up small scale firms since they are guaranteed tax relief till their investments have become profitable.
- Ensuring macro-economic stability for example controlling inflation (stabilized prices/controlled inflation). The government is trying to control inflation and maintenance of price stability which discourages speculation in the economy and encourages increased production for exchange
- Encouraging economic integration to expand market. This is aimed at minimizing wastage of resources thereby encouraging the potential local investors to join production and existing investors to expand so as to increase output and earn more profits hence growth of the small scale firms
- Creation of specialized institutions for investment like Uganda Investment Authority, Uganda Small Scale Industrialists Association (USSIA), Uganda National Chamber of Commerce and Industry (UNCCI), Export Promotion Institutions and Private Sector Foundation to improve performance of the small scale firms. This is because through these organizations government is able to determine ways of assisting the potential local investors to set up small scale firms in the country
- Undertaking economic liberalization. This is through giving liberty to potential local investors to establish firms and increase output by removing unnecessary government controls on trade that tend to inhibit industrial expansion
- Encouraged acquisition of credit for investment. This is through providing low cost credit (loans) to increase capital for buying more land and more raw materials so as to expand the scale of the firms
- Improvement in land tenure system. This is through carrying out land reforms to enable potential investors have access to land for small scale industrial development and the existing investors to get more land so as to expand their firms.
- Improved labour skills. This is through offering training to labour inform of organizing seminars, workshops and on-job training so as to increase efficiency and productivity that enables small scale firms increase the quantity and quality of output
- Encouraging local investors through campaigns by government officials/improved entrepreneurship ability to enable potential investors to acquire the required skills to organize other factors of production thereby facilitate them establish and manage the small scale firms effectively
- Stablished the political atmosphere. This is to build confidence in investors so as to attract local investors to develop and expand the small scale firms because they are assured of safety of their lives and property
- Promoted technological development through research. This is aimed at ensuring the application of appropriate technology in the production process and enabling small scale investors to improve on the quality and increase on the volume of output
- Modernizing agriculture/developing cheaper and reliable sources for the supply of materials/creating linkages with other sectors. This is aimed at enabling the small scale firms to have continuous supply of raw materials hence enabling them to expand
- Fought corruption (promoting proper accountability). This is aimed at ensuring proper accountability and financial discipline thereby availing more funds to small scale investors to expand the scale of operation

Revision Questions

1. (a) Account for the dominance of small scale firms in Uganda
   (b) Discuss the problems faced by small scale firms in Uganda
2. (a) Account for the predominance of small scale firms in your country
   (b) Discuss the measures taken to support small scale firms in your country
3. (a) Account for the continued existence of small scale firms in Uganda
   (b) What are the demerits of small scale firms in Uganda?
4. (a) Account for the survival of small scale firms alongside large scale firms in Uganda
   (b) What are the merits of small scale firms in Uganda?

LARGE SCALE FIRMS

These include

- Steel rolling mills
- Large scale breweries
- Large scale soft drink processing industries such as coca-cola industry
- Large scale textile firms
- Large scale cement making industries such as Hima Cement industry Ltd and Tororo cement industry Ltd

EFFECTS OF LARGE SCALE FIRMS IN DEVELOPING COUNTRIES

POSITIVE EFFECTS OF LARGE SCALE FIRMS

- Low prices of final output due to economies of scale and thus securing large markets
- Provide employment opportunities to people. They operate distribution stores in different parts of the country and this enable more people to be employed by such large scale industries
- They operate distribution stores in different parts of the country and this enables transporting its products at lower per unit cost
- Lead to infrastructural development
- Promote technological development/transfer due to having high possibility of carrying out research
- Contribute revenue to government through taxes
- Lead to economic growth by producing more goods in the economy
- Improve labour skills through training. They stimulate development of skills through on the job training programmes for the workers
- Increased utilization of idle resources hence avoiding wastes
- Promote growth of entrepreneurial abiliy
- Lead to urbanization and its merits
- Save foreign exchange
- Increased foreign exchange earnings due to exportation hence improved BOP position
- Production of quality output hence efficiency in production because they are capital intensive
- Reduced dependence on imported consumer goods. They help to reduce dependence on imported manufactured goods
- Promote linkages with other sectors
- Production of variety of goods hence widening consumer choices
- High profit levels are enjoyed due to low overheads
- Effective management due to use of specialists in the right fields

NEGATIVE EFFECTS OF LARGE FIRMS

- Increase income inequality. They worsen income inequality in the economy
- Lead to imbalance in regional development/rural-urban migration and its evils. They lead to regional imbalance in development since they are mainly concentrated in urban areas

- Environmental degradation through pollution. They create environmental degradation/pollution as they are associated with social costs which inconvenience the public
- Increased dependence on imported inputs. They increase dependence on imported inputs and industrial spare parts. This creates external resource dependence
- Low employment creation due to use of capital intensive techniques. They give rise to technological unemployment due to the use of capital intensive techniques of production
- Lead to over exploitation of resources hence depletion
- Capital outflow due to wages and profit repatriation. Continuous capital out flows as a result of profit repatriation by foreign investors who own large scale industries
- Balance of payment problems due to importation in inputs. It results into BOP problems due to massive importation of industrial machines through technological transfer
- Political interference due to exertion of pressure on government for concessions. They investors always lobby government to be given supporting incentives like tax holidays. Through providing such subsides, government expenditure increase in the long run and this lowers the net benefits from large scale firms
- Lead to monopoly tendencies and its demerits, for example, consumer exploitation and collapse of small scale firms. Some large industries have monopoly tendencies and they exploit the public or the consumers
- Expensive to establish/set up
- Heavy losses are incurred in case of breakdown/failure
- Surplus production due to limited market hence wastage
- Diseconomies of scale hence high prices for final products
- Difficult to relocate/not flexible
- Production at excess capacity hence wastage of resources
- Consumer exploitation by way of charging high prices

REASONS WHY FIRMS IN THE SAME INDUSTRY PRODUCE DIFFERENT LEVELS OF OUTPUT

Question: Account for the differences in the levels of output of firms in the same industry

- Differences in stock of capital/differences in financial position of the firm
- Differences in market size
- Differences in entrepreneurial ability/organization skills
- Differences in levels of technology used in production
- Differences in quality and quantity of labourforce
- Differences in objectives or goals of the individual firm
- Differences in the level of infrastructural development
- Differences in prices/cost of the factors of production
- Differences in political atmosphere
- Differences in geographical location of the firm
- Differences in government policy as regards taxation and subsidization applied to the different firms within the same industry
- Differences in quality of inputs/raw materials used
- Differences in amount of profits earned by the firm
- Differences in total volume of sales made
- Natural factors

ECONOMIES OF SCALE AND DISECONOMIES OF SCALE

Economies of scale are the advantages of large-scale production enjoyed by firms in form of reduced costs of production

As the production increase, efficiency of production also increases. The advantages of large-scale production that result in lower unit (average) costs (cost per unit) as the reason for the economies of scale in that the total costs are shared over the increased output

These can be classified as;

- External economies of scale
- External economies of scale

NB: Economies of scale can also be classified as

(a) Pecuniary economies; these are advantages enjoyed by a firm operating on a large scale in monetary terms

Or

The advantages enjoyed by a firm by way of less or reduced monetary (financial) costs in producing greater levels of output

These may take the form of discount on bulk purchases of inputs, lower interest rate on loans from banks etc

(b) Real economies; these are the benefits enjoyed by a firm operating on a large scale in form of saving on the quantity of inputs, for example, factor inputs such as labour, capital, raw materials etc

Internal economies of scale

Internal economies of scale are advantages enjoyed by a firm as it expands due to favourable conditions within the firm.

When a company reduces costs and increases production, internal economies of scale have been achieved

Internal economies of scale relate to the lower unit costs a single firm can obtain by growing in size itself. There are nine types of internal economies of scale

Examples of internal economies of scale include

1. Technical economies
   (i) The large firm can introduce more division of labour and specialization as it increases in size. Small firms employing on a few staff have less scope for division of labour
   (ii) The large firm can afford to employ large and specialized machinery. Moreover, the firm has the large output to fully occupy the machine over a long period of time and therefore, it can be operated efficiently. Indeed, some machines are indivisible in that they are only efficient if they are large in size eg blast furnaces used in the steel industry
2. Financial economies
   (i) The large firm can easily get large bank loans. This is because they can offer more security for the loan than could a small firm and the risk of default is also less. They sometimes get less loans at lower rates of interest owing to confidence of the bank in their ability to repay
   (ii) Large firms can issue shares and debentures on the stock exchange. Again investors are more likely to have confidence in buying these securities in a large company like the Uganda Breweries Ltd than in a small company like the City Shoppers Supermarket in Mukono
3. Marketing economies
   (i) Large firms can afford to advertise on television and in newspapers and magazine. Indeed the firm may produce so many related products that the brand name helps to advertise all of these different products. The large firms can afford to buy in bulk and they usually purchase raw materials in bulk and succeed in paying lower prices and enjoying special privileges (eg discounts) from the supplier

(ii) The large firm has many advantages on the selling side also. For instance, the large firm can afford to employ specialist sellers (and buyers) which will give great advantages. Moreover, packing and distribution costs are like to be lower per unit of output as are transport, clerical and administration costs. It is usually cheaper per unit of output to package and distribute 1,000 units than 100 units

4. Managerial economies
Specialists can be employed in every department of the large firm. Specialists buyers and sellers can be employed. There will be specialists on transport, personnel and administration. So Adam Smith's principle of division of labour can be applied to management, too. Managers can specialize in their own departments rather than attempting to perform several different roles

5. Risk-bearing economies
Businesses are faced with many risk eg changes in consumer demand. Large firms are better able to bear such a risk of decline in demand for a particular product because they will probably have diversified their output. They will produce a wide variety of different goods and can face the situation where demand for a particular produce declines. Risk-reduction is achieved through product diversification

The large firm is also better able to sell products in different regions of India and even to export to other countries. Thus again they are able to spread their risks. The small firm, on the other hand will suffer from the problem of having all its eggs in one basket. Therefore, if demand for the good declines then the small firm is likely to lose money considerably any go out of business

6. Welfare economies
Large firms can afford, more than small firms, to spend money on providing good working conditions, canteen, social and leisure facilities for employees. This makes workers happy and therefore, more productive

7. Storage economies
A large firm can afford to own or hire a warehouse for storing raw materials and finished products

8. Transport economies
A large firm can afford to own vehicles or trucks to bring in supply of raw materials and to distribute the final products

9. Research and development economies
A large firm possesses large amount of capital that can finance research and development leading to new and better methods of production

Summary

Question: Discuss the benefits of large scale production enjoyed by firms in an economy

- Technical economies of scale
- Managerial economies
- Marketing economies
- Financial economies
- Storage economies
- Transport economies
- Welfare economies
- Research and development economies
- Economies of concentration
- Economies of specialization

External economies of scale

External economies of scale are advantages enjoyed by the firm due to expansion of the industry or due to favourable conditions created for the firm by the industry.

It is normally associated with a particular area. External economies of scale occur outside of a firm, within an industry. Thus, when an industry's scope of operations expands due to, for example the creation of a better transportation network, resulting in a subsequent decreases in cost for a company working within that industry, external economies of scale are said to have been achieved

External economies of scale occur when a firm benefits from lower unit costs as a result of the whole industry growing in size

Examples of external economies of scale include

- Economies of concentration. These are the benefits enjoyed by a firm due to expansion of an industry in an area. For example
  - (i) Transport and communication links improve. As an industry establishes itself and grows in a particular region, it is likely that the government will provide better transport and communication links to improve accessibility to the region. This will lower transport costs for firms in the area as journey times are reduced and also attract more potential customers
  - (ii) Training and education become more focused on the industry. Universities and colleges will offer more courses suitable for a career in the industry which has become dominant in a region or nationally
  - (iii) Other industries grow to supper this industry. A network of suppliers or support industries may grow in size and/or locate close to the main industry. This means a firm has a greater chance of finding a high quality yet affordable supplier close to their site.
- Economies of specialization
  - (i) When an industry grows in size, firms may specialize in different activities/fields, for example in the textile industry, some firms specialize in ginning, spinning, weaving and dyeing which increase the efficiency of the firm

    Labour in a particular area may become skilled at a specific occupation. A firm in the area should have less of a problem in finding supplies of labour with the skills required. Such skills are handed down from generation to generation and the expectation is that the child will follow the parent into a particular trade
  - (ii) Specialized services; specialized banking, marketing, insurance services will have grown up in the area to deal with the particular requirements of the industry
- Economies of information. The firms in the region may co-operate and take advantage of research centres in the area. Also, firms may come together and form trade associations or chambers of commerce to represent the interests of the industry to the government and community as a whole
- External technical economies. Firms in the industry can share specialized maintenance facilities like garages, carpentry workshops etc thereby reducing average costs
- Economies of social welfare. An industry is in a better position to provide welfare facilities, for example setting up a health centre, school, football groud etc

DISECONOMIES OF SCALE

These are the problems faced by businesses if they become too large. By definition, diseconomies of scale are the disadvantages of large scale production in form of increased average costs suffered by a firm or a number of firms in an industry

These can be classified as

- Internal diseconomies of scale
- External diseconomies of scale

Internal diseconomies of scale
These are disadvantages experienced/suffered by a firm as it expands due to unfavourable conditions within the firm
Examples of internal diseconomies of scale include
- Managerial or labour diseconomies of scale. As a firm expands in size, it becomes difficult for the management to supervise and control workers hence managers lose touch with the workers; communication problems become apparent because the business is so large which affects decision making etc
- Technical diseconomies of scale. As a result of over expansion of the firm, capital depreciation (wear and tear of machines) increases and capital consumption allowances has to be put aside to cater for the wear and tear. This increases the average costs of production
- Marketing diseconomies of scale. The overexpansion of the firm may result into marketing problems, for example losing touch with the customers, selling of the surplus output may be costly in terms of advertising or sales promotion etc leading to increase in average costs of production
- Financial diseconomies of scale. The over expansion in the size of the firm makes it difficult to get enough funds to support the production process and a firm may be forced to borrow at high interest rates leading to increase in the average costs of production

External diseconomies of scale
These are disadvantages experiences/suffered by the firm due to expansion of the industry or due to unfavourable conditions created for the firm by the industry
Examples of external diseconomies of scale may include
- Pollution of air and water resulting from congestion of factories. This leads to increase in the average costs due to need to purity the air and water
- Increased costs of land due to increased competition between the firms
- Increased labour costs due to increased demand for different types of labour
- High transport costs due to traffic congestion
- High costs of raw materials and other inputs due to high demand for them
- Increase in costs of accommodation because of high competition for houses leading to the development of slums

Survival of small scale firms
Account for the predominance of small scale firms in developing countries
Or
Account for the continued existence of small scale firms in your country
A summary of the possible answers
- Poor infrastructures
- Limited capital for example expansion/they are cheap to state
- Fear of diseconomies of scale
- Limited labour
- Fear of increased taxes
- Limited supply of raw material
- Limited market size
- Poor techniques of production
- Choice/objective of the entrepreneur
- Fear to loose independence
- Market requiring personal touch
- Limited entrepreneurial ability
- Poor land tenure

- They are used as pilot projects/for research purposes
- They are flexible
- They are easy to manage and control

LOCATION AND LOCALISATION OF AN INDUSTRY

LOCATION OF INDUSTRY

Location of industry refers to a place or site or point at which an industry or firms producing related products is/are set-up/established

Or

Refers to the establishment or setting up of an industry in an area

Or

Is the choice of a site where an industry/firms producing related products is/are set up

FACTORS THAT INFLUENCE LOCATION OF AN INDUSTRY IN AN AREA

The factors that have influenced location of industry in Uganda include;

- Availability of power/electricity and energy to run machines in industries. Most firms are located near a reliable source of power supply for the proper running of machines
- Availability of land to give room for future expansion. Firms tend to be located in areas where there is enough land for future expansion
- Availability of capital (both real and money capital). Firms are set up in area when there is capital to by the necessary inputs and machinery for production to take place
- Availability of labour that can be employed in industries
- Availability of raw materials or inputs such as minerals, agricultural produce, water that can be used in industrial operations
- Accessibility to infrastructure such as roads, rail lines, communication facilities etc this is to make it possible to carry the raw materials and machinery to the sites and the finished products to the market
- Nearness to market/proximity to market for the industrial goods. Firms are located near the main markets to reduce transport costs for the finished products and for quick delivery especially of perishable products
- Government policy on industrialization. The government encourages entrepreneurs to establish firms in certain areas designated as industrial areas by offering free land, tax holidays, necessary security and infrastructure etc for example, Namanve industrial park
- The existing political climate/ Availability of security. Firms locate in areas that are relatively peaceful for purposes of giving confidence to the owners about the security of their life and property
- Availability of ancilliary/ancillary services such as banks, insurance, warehouse health centres etc
- Availability of water. This is necessary as a raw material in some firms like the beverages industry and for cooling the machines
- Existence of other industries in an area. New industries tend to be attracted to areas where there is a concentration of other firms. This is because of the already established infrastructure existence of a pool of skilled labourforce and other industrial linkage possibilities

SOME KEY TERMS

Frootloose industries are industries that can be located in any place regardless of the source of raw materials without affecting the costs of production

While

Rooted industries are industries that are located in a particular place where the source of raw material is for the cost of production to be minimized

FACTORS TO BE CONSIDERED BY A BUSINESSMAN IN LOCATING A BUSINESS

- Government policy in setting up the business in a particular area
- Cost of rent

- Competition posed by other business
- Existence of room for expansion. A business may wish to expand. Therefore, there must be available low cost land to enable grow and reorganization of the business
- Existence of labour/staff. A sufficient and suitable supply of labour should be available
- Type/nature of goods dealt in
- Availability of market or people or demand condition of consumers
- Accessibility or Availability of transport. A reliable and efficient system of transport is essential. Attention must be paid to the Availability of a good road network
- Availability of auxiliary services. It is essential that services such as banks, hospitals, places of entertainment, etc are close to the business
- Availability of easy communication facilities
- Existence of power and its cost. The business should be located near a source of power. The cost of erecting and maintaining the power line should be minimal
- Access to suppliers of stock
- Political situation or security in the area. A business is usually established in a secure area because of the confidence the entrepreneur attains
- Existence of water and its cost. Attention must be paid to the availability and frequency of water services when choosing to locate the business

LOCALIZATION OF AN INDUSTRY

Localization of an industry refers to the concentration of an industry in an area in order to enjoy external economies of scale

Or

Is the concentration of firms producing related products in an area in order to enjoy external economies of scale/reap advantages of location

Thus, localization of industries is the concentration of industries in a given area, (due to existence of favourable locational factors like cheap labour). It means the planned concentration of several factories of a certain type of industry in one place, for example establishing foam industries in Kyambogo

Merits of localization of industrial firms in a market economy

- Promotes forward and backward linkages between firms. The large firms encourage the development of subsidiary firms, for example, the sweets industry from a sugar industry ie promotes interdependence among industries because bi-products (by products) of one firm are used as raw materials in another firm
- Increased security of an area in the national interest. It becomes easy for the government to extend security services to firms because they are concentrated in one area. Government assistance in form of providing security is easily obtained. This is because government is interested in developing the area where industries are localized for national interest
- Leads to growth of auxiliary services in the area. Specialized services firms like banking and insurance tend to develop in the area which helps to lower the cost of doing business
- Leads to growth and development of organized markets/expansion of markets for the products. It creates market for goods because of many people that are attracted in the localized area
- Leads to development of a pool of skilled labour in an area. Creates a potential pool of skilled labour force as people in a localized are willing and interested in learning the skills needed in the localized industry, overtime, they become specialized and employable in the industry
- Encourages specialization and its advantages. This is because each firm in a localized area tends to concentrate on a particular production process for the provision of different types of goods and services
- Leads to low prices of final products. This is because of the high competition among the many firm that makes them lower prices of their final products

- Leads to co-operation of industries in solving common problems. The costs of production like advertisement and transport are reduced because firms share such costs
- Creation of more employment opportunities in the area. Creation of greater employment opportunities, due to the large number of firms. Many jobs are created by the localized industry and this improves income of the people in an area leading to serve the industries
- Leads to increased reputation or popularity of an area. The place where the industry is located gains popularity and so are the products manufactured in that area. More investors are attracted to set up industrial firms leading to production of more goods and services in that area
- Leads to increased resource utilization in the area/leads to utilization of would be idle resources. This is due to the many firms that results in high demand for resources for their production process
- Encourages/facilitates infrastructural development in the area. There is viable development of basic infrastructure like roads, schools, banks etc. since many firms are in the area, the government delivers services and develops economic infrastructure (roads, rail lines, telephones lines) more easily
- Leads to increased revenue to the government from the area. This is because government imposes taxes on localized industries hence a source of revenue
- Leads to increased production of quality output due to competition. There is intense competition for market that forces firms to improve on product quality
- Leads to production of a variety of products in the area. This is due to the many firms in the area that offer a variety hence widening consumer choices
- Leads to increased quantity of output hence promoting economic growth. This is due to increased production from the many firms in the localized area

Problems associated with localization of an industry

- Leads to overstraining of infrastructure. Localization increase pressure on social and economic facilities like schools, hospital, water and electricity. The government is therefore forced to divert resources form other sectors in order to provide these facilities in the area where industries are localized
- Encourages rural-urban migration and related problems. The imbalances between rural and urban areas results into rural urban drift with its associated problems like development of slums, urban crime, urban, unemployment as some people from rural areas fail to get jobs in the localized industries. It creates congestion of population and traffic and lack of adequate housing and related problems like slums, diseases etc
- Leads to uneven regional growth and development. Localization of industries concentrates production in one area or a particular part of the count. This results into some areas lagging behind in terms of industrial development
- Leads to problems of income inequality. This is due to the uneven development of industries that results in income being concentrated in the hands of the few employed in a localized area
- Causes environmental degradation and pollution related factors like noise. Localization of industries causes excessive pollution of air and water due to industrial waste and emissions from manufacturing plants. This puts people's lives and the environment in danger. Pollution reduces the quality of life for the people and causes environmental degradation through noise, dust, smoke, drainage, sewerage systems etc. for example the drainage problems of Bwaise and Kyambogo
- Leads to increased cost of land/high rent rates. This is due to the many firms in the localized area that compete to the limited land resources forcing a rise in the rental charges
- Leads to quick depletion/exhaustion of resources in an area. This is due to the many firms that compete to utilize the available resources leading to their depletion
- It leads to displacement of people in an attempt to localize firms in area, making them landless. Many industries investors are forced to encroach on land meant for resident purposes in order their

industrial activities. This results into displacement of people to other areas where they can settle/set up residential houses

- Leads to rising cost of living in the area. This is because some goods and services especially foodstuffs and accommodation (housing) become expensive
- Leads to increased cost of labour. This is due to the high competition for skilled workers in the area
- Leads to rising costs of inputs. It leads to competition among firms in the same area leading to increase in the costs of operation. Because of stiff competition for factor inputs, such as land and labour, individual firms have to pay higher prices in order to obtain these inputs. This leads to higher costs of production which may passed on into high prices for final products

NB: Industrial inertia is the tendency for existing industries to remain located in an area and even new ones to be attracted to an area even when the original advantages of that area do no longer exist

NB: Industrial location is the establishment of an industry in an area in a particular period of time

Reasons why the government influences the location of an industry.

The government should influence the location of an industry because of the following reasons

- To provide more employment opportunities of the national in different areas
- To ensure balanced regional development
- To reduce problems of rural-urban migration
- For strategic reasons or defence
- To reduce social costs of localization
- To encourage exploitation of formerly idle resources, for example oil
- To ensure fair income distribution
- To fulfill political obligations so as to win the support of the masses
- To avoid unnecessary duplication and wastage of resources
- To control monopoly tendencies

Circumstances under which the government may influence location of industries

- When the government wants to minimize monopoly tendencies
- When there is need to fulfill political obligations
- When there is need to ensure equal regional balance
- When government wants to increase employment opportunities
- When the government wants to exploit resources in a certain area
- When there is need to fulfill strategic reasons
- When there is need to ensure fair income distribution
- When there is need to minimize adverse effects of localization
- When there is need to avoid unnecessary duplication and wastage

DELOCALIZATION

Delocalization refers to a deliberate policy of establishing industries in areas which do not have any or have few industries, that is, a means of spreading a particular industry ie redistribution of industrial activities in different parts of the country

Merits of delocalization

- It reduces congestion in form of traffic jam and housing
- It reduces the over exploitation of resources
- It reduces the cost of production because of reduced competition
- It leads to low levels of both air and water pollution
- It leads to a reduction of social evils like prostitution
- It leads to a reduction of rural – urban migration
- It wins political support for the government
- It leads to balanced development in the country in form of roads and banks

- ➢ It solves the unemployment problem as jobs are spread in the country
- ➢ It minimizes loses during periods of war when a localized area is targeted
- ➢ It can lead to utilization of idle resources like labour
- ➢ It leads to an increase in government revenue due to many industries in various places being taxed

Question:

(a) Distinguish between location and localization of industries
(b) What factors influence the location of an industry
(c) Explain the disadvantages and disadvantages of localization of an industry

GROWTH OF A FIRM

This refers to the expansion of a firm over a long period of time. Firms grow in order to achieve their objectives, including increasing sales, maximizing profits or increasing market share

Firms may grow in size both internally and externally

1. Internal expansion or natural growth of a firm is where a firm expands on its own by the owner's policy of ploughing back profits, that is, re-investing the profits into the business or expanding the range of products. To grow organically, a firm will need to retain sufficient profits to enable it to purchase new assets, including new technology. Over time, the total value of a firm's assets will rise, which provides collateral to enable it to borrow to fund further expansion
2. External expansion or artificial growth of a firm is where a firm uses external means and resources of other firms to attain expansion. This is usually through amalgamation/merging/integration of firms

AMALGAMATION/MERGING/INTEGRATION OF FIRMS

Amalgamation is where two or more firms will separate entities combine to form one big business in order to enjoy economies of scale

Ways of amalgamation

- ➢ Complete amalgamation/consolidation. All companies intending to amalgamate dissolve, combine and create a completely new company to take over their business. If Tororo cement industry Ltd and Hima Cement Industry Ltd with to have a consolidation, they may go into voluntary liquidation. A new company is then formed to take over the assets and liabilities of the two liquidating company. The new company may be named Tororo-Hima cement industry Ltd
- ➢ Absorption/merger. One company takes over the business of other companies completely but retains its entity. Shareholders in the liquidating companies will be issued with shares in the merging company. An example of an Absorption is where monitor publications ltd may be taken over by the new vision printing and publishing company ltd
- ➢ Cartel; various companies agree to sell their products through a central selling agency but do not combine as such. They retain their entities. For example oil producing countries sell their oil through OPEC(Organization of Petroleum Exporting Countries) which is a cartel
- ➢ Holding company, various companies enter into combination but retain their entities. A holding company is one that has bought more than 51% of the share capital of other companies known as subsidiary companies. An example of a Holding company in Uganda is Madhvani Group (U) Ltd which controls subsidiary companies like Nile Breweries Ltd, Madhvani Tea Ltd, Kakira Sugar Works etc

FACTORS WHICH DETERMINE/INFLUENCE/AFFECT THE GROWTH OF A FIRM

An explanation of factors which determine the growth of a firm in an economy

- ➢ Size of the market served. The bigger the size of the market served, the higher the chances of expansion of the firm and the smaller the size of the market, the lower the chances of expansion of the firm
- ➢ Availability of capital/finance/funds. A firm with increased access to finance greatly expands in size while a firm with limited access to finance usually operates on a small scale
- ➢ Level of supply of raw materials

- State or nature of available infrastructure. Improved infrastructure leads to increased production and greater expansion of the firm while poor infrastructure limits the expansion of the firm due to low levels of output arising from inability to access inputs and areas of market for final products
- Level of technology used/employed. A firm that employs modern and advanced technology usually expands in size while firms that employ poor or backward and inefficient technology usually operate on a small scale
- Availability of land for expansion. Increased access to land encourages operation on a large scale due to high chances of expansion of the production unit while poor land tenure system makes it difficult to expand the scale of production
- Government policy of taxation and subsidization. High levels of taxation in the economy discourage firms from integrating for fear of reduced profitability of the business while low taxes and increased subsidies in the economy encourage firms to merge and expand in size to take advantage of the reduced costs of production
- Nature of goods and services produced. Firms producing capital goods usually operate on a large scale compared to firms producing consumer goods that usually operate on a small scale
- Objectives/goals/aims of the owners of the firm. Expansion of a firm greatly depends on the aim of the owner of the firm, for example an entrepreneur who aims at maximizing sales-revenue operates on a large scale while an entrepreneur aiming at creating employment for family members usually operates on a small scale
- The availability of skilled labour. Increased access to skilled labour leads to greater levels of output hence expansion of a firm while limed supply of skilled labour results in low levels of output making a firm to operate on a small scale
- Possibility of production of new goods. Once there is a possibility of launching new products through allocation of more funds to research and development (R&D) and generate new products as a consequence; firms are likely to expand as this may increase their competitiveness and profitability in the long run. On the contrary firms with no possibility of launching new products may not readily expand for purposes of concentrating on creating market for the existing line of business
- Political atmosphere. Political stability builds confidence among entrepreneurs thereby encouraging increased production hence greater expansion of the firm while political unrest scares away entrepreneurs thereby discouraging production hence operation on a small scale.
- Possibility of merging. A firm may expand in size when there are chances of bringing together under unified management the assets of two or more firms to enjoy economies of scale while a firm that desires its independence has no ambitions of expanding hence continues operating on a small scale
- Level of managerial efficiency of the firm/level of entrepreneurship. Improved managerial efficiency leads to increased production due to proper organization of the production process hence greater expansion of the firm while poor management results into poor organization and low levels of output hence limited expansion of the firm
- Possibility of production of new goods. A firm with high chances of producing new goods usually operates on a large scale hence can easily expand the scale of operation while a firm that has no intention of producing new goods and is contented with the existing products on market operates on a small scale

INTEGRATION OF FIRMS

This is the bringing together under unified management the assets of two or more firms in order to enjoy economies of scale. Firms integrate through mergers, where there is a mutual agreement, or through acquisitions, where one firm purchases shares in another firm, with or without agreement.

REASONS FOR THE MERGIN OF FIRMS

Reasons for the merging of firms include the following

- To encourage efficiency/improve quality of output
- To reduce the average costs of production/to enjoy economies of scale
- To attain monopoly power
- To effectively exploit available resources
- To minimize unnecessary duplication and wastes
- To increase output

TYPES OR FORMS OF INTEGRATION OF FIRMS

There are several types of integration, including

1. Horizontal integration
2. Vertical integration
3. Lateral integration
4. Conglomerate or diversified integration

- Horizontal merging of firms occurs when two or more firms in the same industry at the same stage or level of production unite into one production unit

  Or

  Is the union or combination of two or more firms in the same industry and at the same level production

  Or

  Horizontal margining of firms is the bringing together assets of two or more firms at the same level/stage of production to tap economies of scale eg Nile breweries combining with Uganda Breweries in the Beer Industry

  ADVANTAGES OF HORIZONTAL MERGING OF FIRMS

  - Reduced competition for raw materials
  - Reduced costs of advertising
  - Improved efficiency in management
  - Reduce duplication of goods and services because of minimal wastage and costs (or controlling/avoiding duplication and waste)
  - Optimal levels of production/full capacity utilization of resources/optimal utilization of installed capacity
  - Research is possible/easy
  - Sharing of risks is possible
  - Increased output/sales/firms enjoy higher profit levels
  - Access to better technology
  - Reduced competition for market/widens markets
  - Increased access to capital/loans
  - Reduced prices due to low cost of production
  - Allow for firms to enjoy economies of scale

  DEMERITS OF HORIZONTAL MERGERS

  - Firm becoming too powerful in market (monopoly tendency)
  - Rise in price of products
  - Compromising quality
  - Limited resource utilization

- Loss of employment by some workers
- Managerial diseconomies of scale
- Technical diseconomies of scale
- Marketing diseconomies of scale

- Vertical merging of firms is the joining or combination of two or more production units in the same or related industry but at different stages of production

  Or

  Occurs when two or more firms combine in the same industry but at different stages of production unite or combine into one production unit (eg a tea growing firm combines with a tea processing firm)

  Or

  The bringing under unified management the assets of two or more firms in an industry but at different stages of production in order to enjoy economies of scale

  Or

  Vertical merging of firms occurs when two or more firms in an industry but at different stages of production unite/combine into one production unt eg a tea growing firm combining with a tea processing firm

  Or

  Vertical merging of firms arises when two or more firms in the same industry but at different levels/stages of production join together eg raw materials firm and a processing firm

  There are two types of vertical integration, backwards and forwards
- A company exhibits backward vertical integration when it controls subsidiaries that produce some of the inputs used in the production of its products ie backward vertical integration occurs when a firm merges with another firm which is nearer to the source of the product, such as a car producer buying a steel manufacturer. For example, an automobile company may own a tyre company, a glass company, and a metal company, control of these three subsidiaries is intended to create a stable supply of inputs and ensure a consistent quality in their final product
- A company tends towards forward vertical integration when it controls distribution centers and retailers where its products are sold ie forwards vertical integration occurs when a firm merges to move nearer to the consumer, such as a car producer buying a chain of car show rooms

  Illustration
- Lateral integration is the brining together assets of two more firms producing products that are related but not the same but can be conveniently marketed together eg shoes and shoe polish making firms
- Conglomerate or diversified, integration is where firms dealing in unrelated products merge for the purpose of achieving diversification of activities eg a bookshop and a restaurant

  Or

  Conglomerate is a merger or takeover that involves firms which produce goods that are not in the same industry or related to each other

  Or

  A Conglomerate merger is where two or more firms combine though they do not produce related goods

  Or

  A combination/take over involving firms that produce goods or services that are not related

  Or

  A Conglomerate merger is takeover or putting under similar management firms that are in different industries usually for purposes of diversification

  NB: Conglomerate mergers happen when two companies that offer varying services or are involved in different sectors of business merger together. This type of Conglomerate merger can occur when two similar companies are deciding to merge in order to spread themselves better throughout the market. This ensures the two companies as one entity are a stronger company than they would be on their own

Merits of Conglomerate mergers

- Diversification of risks
- Widening scope of investment portfolio
- Creating new raw material links
- Taking advantage of common market outlets
- Creating technological links

Question: What are the merits and demerits of integration of firms in your country?

MERITS OF INTEGRATION OF FIRMS

- Reduces competition for market outlets. Horizontal merger reduces the competition by reducing the number of companies which are there in the industry and hence company has to spend less time on taking undue stress about how to tackle competition and can concentrate more on improving its product and giving the customer best services by producing good quality product at lowest price
- Reduces competition for raw materials. Merging results into increase in bargaining power with suppliers due to massive size of merged company
- Reduces duplication and wastage of raw materials. As a result of merging there is elimination of duplication of machinery and raw materials hence price per unit of production for product decreases
- Increases firm's access to skilled labour. When firms merge, they can share knowledge with each firm benefiting from the knowledge and experience acquired by the other
- Leads to increased output and profit due to the widened market
- Horizontal merger is that it reduces the competition by reducing the number of companies which are there in the industry and hence company has to spend less time on taking undue stress about how to tackle competition and can concentrate more on improving its product and giving the customer best services by producing good quality product at lowest price
- Enjoyment of economies of scale due to large scale operations that reduce the average costs of production. Firms that merge can take advantage of a range of economies of scale. Such as cost savings associated with marketing and technology
- Leads to optimum exploitation of resources hence avoiding waster
- Enables firms to share risks, for example losses. Rationalization is the process of eliminating parts of a business that are inefficient or unprofitable, and is a possible consequence of two or more firms merging
- Reduces costs of adverting because of reduced competition for market. Merging leads to less expenditure on advertising and publicity leading to company delivering the product at lower price to its customers than before
- Increases firm's access to loans due to possession of collateral security by a merger
- Increases capital base of the firm
- Leads to production of better quality output through research
- Enables the firm to employ better technology because of increased research/innovations. Firms that merge may be able to allocate more funds to Research and Development (R&D) and generate new products as a consequence. This may increase their competitiveness and profitability in the long run
- Increased efficiency of management due to sharing ideas and employment of specialist

DEMERITS OF INTEGRATION OF FIRMS

- Leads to unemployment due to downsizing of the workforce upon merging. Rationalization is likely to lead to lost jobs as the merged firms attempt to increase profitability. For example two advertising agencies that merge could dispense with two design departments and share one

- Leads to overproduction and wastage of scarce resources
- Leads to overexploitation of resources hence depletion due to over expansion of the business
- Leads to a monopoly situation and association problems like over pricing of products leading to consumer exploitation. Higher prices are likely consequence of a merger because with less competition, demand is more inelastic and raising price will raise revenue
- Results into higher levels of taxation of the firm which increases the costs of production and reduces the profit level
- Leads to diseconomies of scale arising from over expansion of the production units. Firms that merge may experience diseconomies of scale such as difficulties with co-ordination and control. This will increase average cost in the long run, and reduce profitability
- Inefficiency in management due to complexity in organization. This is because it is difficult to integrate the culture, employee behavior and other such things of two companies which are merged due to sheer big size of merged company
- Leads to loss of identity or independence which is not desired by some of the small scale firms

FACTORS LIMITING INTEGRATION OF FIRMS IN UGANDA

- Fear of high taxes imposed on a single big firm. Some firms prefer to remain operating on a small scale instead of merging for fear of the high taxes imposed on a single large firm that reduces the profitability of the business
- Limited market size/low demand. The existing market may be too small for the output of a merger, making some firms to opt or decide to remain existing independently
- Fear of unemployment to highly skilled labour and other workers. Some firms fear to integrate due to downsizing of the workforce upon merging that leads to loss of jobs to some of the members of management and employees
- Fear of losing close touch with clients/fear of loss of direct contact with consumers. Some firms fear to integrate because they will lose personal contact with their customers, for example clinics and law firms desire to remain independent to keep in touch with their clients
- Fear of diseconomies of large scale production ie (Fear of complexities in management, fear of undertaking higher risks, increased average costs etc). firms fear to merge because those that merge may experience diseconomies of scale, such as difficulties with co-ordination and control. This will increase average cost in the long run, and reduce profitability
- Differences in aims and economic objectives of the firms. When two companies merge, it is more than just the coming together of names or brands – it is the joining of two groups of entrepreneurs who bring along their own specific goals. If two firms have very different aims, conflicts can arise and this may make it difficult to integrate
- Shortage of skilled labour. Firms fear to integrate because of the shortage of highly skilled labour that may be required in the management of the large firm that arises
- Government anti-monopoly legislation. The government may impose laws against the emergence of monopolies through mergers for fears of possible consumer exploitation
- Fear to share losses/ reluctance to share profits. The fear of collective responsibility in case of any losses makes firms not integrate. For example, horizontal merger results in company putting all its eggs in one basket implying that if the product which is being sold by the company go out of fashion as is the case with technological products or if there are some products. Hence a company doing horizontal merger is basically investing all its wealth or cash into one business and there is no diversification and can cost the company big time
- Fear of bureaucratic delays. Some firms fear to integrate because the bureaucracy needed to take care of the merger can be a detriment to the new Conglomerate. Upon merging, the structure of the company will be changed, creating potential decision-making problems along with the advantages

- Differences in techniques of production. Merging of firms with nothing in common in terms of techniques of production may not be possible
- When firms are dealing in unrelated products requiring different fields of specialization. Where the activities done by firms differ or are unrelated, firms prefer to remain independent and specialize in different fields
- Fear of not achieving an optimum level of output. When firms merge, they may not product at full capacity hence the fear of not achieving the optimum level limits merging
- Fear of loss of independence/autonomy/prestige enjoyed by small scale firms. Firms fear to integrate because of the higher levels of interdependence and mutual consultation in the management decisions of a large firm
- Long distance between the different firms