Private and Public Sectors

The British Economy is divided into two sectors, the Private Sector and the Public Sector.

The Private Sector

The private sector is made up of all the businesses operating in the UK. All the Sole Traders, Partnerships, Co-operatives LTDs and PLCs are in the private sector. The private sector encourages efficiency through competition. Competition gives us choices of where to shop and what to buy. Competition reduces prices, and improves quality.
But the private sector is not effective in producing some goods and services which we need to make the whole economy become more productive and work better, and also fails in supplying some of our basic needs. This is why we have a public sector.

Objectives of Private Sector Firms

Profitability. The most obvious objective of any business is to make profits, that is a return on the capital (money) invested in the business. After all, why on earth run a business or invest in a business, if there is not going to be a worthwhile cash return? Profitability can be measured in a number of ways (you will learn these in detail when you study Financial Accounts), these measures of profitability include Gross Profit, and Gross Profit Margin, Net Profit and Net Profit Margin, and Return on Capital Employed (a measure of profitability against money invested).

When examining profits a firm will need to make comparisons against rival forms, and so benchmark their own profitability. Long run increases in all measurers of profitability, linked to increasing shareholder value (see below), will be the main factors that create ongoing motivation in business owners and managers.

Profit maximisation is a key expression when considering how profitable a firm is. Many firms have been taken over because opportunities to increase or maximise profits have been spotted by predatory outside investors. Profit maximisation is often based on maximising brand value and minimising costs.

Increasing Shareholder value—measured by dividend paid and share price. Dividend is the share of profits paid out to shareholders, so a dividend could be 4p per share. The important figure is Dividend Yield which is the amount of dividend as a proportion of the share price. Increases in share price are expected over time, the total increase in value of shares held is called capital gain. Many senior managers have bonus schemes related to increasing share prices and dividends, these will then become the main focus of the business. This is likely to be seen as both a short run and long run objective

In the shorter term other objectives can arise, and for some businesses these can, at least for the immediate future, be more important than making profits.

These other objectives include;

Survival - around 30% of businesses fail within 2 years of being set up. So for a small business, the initial objective is to survive the difficult time of gaining customers, establishing a good local name, and building a reputation. Even for some big businesses survival can become a priority. Marconi, one of Britain's most successful high-tec engineering firms in the 80's and 90's, was taken over by it's banks in 2002, as a result of falling profits and an inability to pay it's debts. Euro Tunnel is in a similar situation, with £6 billion of debt, and not earning enough profits to pay interest on this debt mountain.

Gaining Market Share - some firms will spend to gain customers, reducing profits in the short run, but hopefully increasing profits in the longer term. They may even be able to force other competitors out of the market, by using loss making pricing strategies.

Increasing Brand Identity- some firms may concentrate on establishing their brand name, becoming the most recognised firm in their market. This costs money, so reducing profits.

Ethics and going green - there are businesses that will try to minimise the impact of their business activities on the environment, they may try to ensure suppliers in developing counties get a good deal, they may pay their workers over the odds. All of theses ethical strategies will increase costs and so reduce profits.

So we see that although making profits, and giving a return to owners (increasing shareholder value), will always be the number one and two priorities of businesses in the long run, in the short term can there be other more important objectives to pursue.

The Public Sector

The public sector is made up of organisations that are owned and run by the government. This part of the economy is huge, and includes some of the largest employers in Europe as well as the UK.

Why do we need a public sector?

Some goods and services which we need in our everyday lives, would simply not be provided by the private sector looking to make profits. These necessities include street lighting, defence (army, navy, air force), and the police. The problem with these goods is that we can all benefit from them without paying for them. So if someone paid for and installed street lighting, anyone walking down that road would benefit - and if you are benefiting without paying, why pay? These goods which will only be provided by the government are called 'public goods'. The economics definition of a 'public good' is that they are 'non rival' and 'non -excludable'.

There is another group of goods and services that is supplied by the private sector, but the quantity supplied of these goods and services by the private sector is likely to be much less than what is good for the economy. The two best examples of these are education and health care. There are of course private schools and private hospitals but most patients are treated by the NHS, and most children go to State Schools. The government spends a great deal of money trying to ensure that we have an effective National Health Service and that we have schools and colleges that supply a well educated and trained work force. These goods 'merit goods' have 'positive externalities of consumption'. A individual gains a degree for their own benefit, and seeks medical treatment for the same reason, but a better educated and healthier workforce increases national output and makes all of us wealthier.

Objectives of the Public Sector .

The main objective of privately owned firms is to make profits, but for organisations in the public sector, performance is measured differently. Instead of looking for profits, we might ask if GP surgeries offer value for money, treating patients effectively, whilst not overspending on medicines or should they be reorganised to offer a more efficient service, so every £ spent has greater benefits for patients? Other ways of measuring effectiveness in the Public Sector is through measuring customer satisfaction or by tables of performance. So inspectors are sent into schools, and exam results league tables are published. The idea of these is to make organisations that are not normally facing competition, to behave as if they have to compete for their customers (in the case of schools that means pupils). And as you know, competition improves efficiency and quality.

We can say then that the main objectives of Public Sector organisations are:

- Provide a quality service
- Provide value for money.
- Provide for customers/consumers needs
- Don't waste tax payers money.
- Provide merit goods
- Provide public goods

Notes