1-1 What is Entrepreneurship?

OBJECTIVES

- ***Define entrepreneurship.***
- ***Recognize the role entrepreneurs play in the U.S. economy.***
- ***Determine the reasons that businesses succeed or fail.***

ENTREPRENEURSHIP

The U.S. economy includes thousands of small businesses. Many of these small businesses are owned and operated by men and women who created their own companies. Some of these individuals have become legends as you hear stories about their path to success. But what makes someone an entrepreneur? What impact have entrepreneurs had in history? What impact do they have today?

WHAT IS AN ENTREPRENEUR?

People who own, operate, and take the risk of a business venture are called entrepreneurs. They are engaged in entrepreneurship, the process of running a business of one's own. Entrepreneurs come from all types of backgrounds and create all kinds of businesses. People of all ages choose to become entrepreneurs. Some own tiny craft shops, while others own huge construction companies. Entrepreneurs try to identify unmet needs in the marketplace. Then they provide a service or product to meet those needs. When they succeed, their businesses flourish, and profits are earned. But if their business idea is unsuccessful, they may lose the money they invested.

Employees vs. Entrepreneurs. Entrepreneurs assume risk. This makes them different from employees, who are people who work for someone else. Both may make decisions, but only the entrepreneur is directly affected by the consequences of those decisions. Sam Jones manages a record store owned by Felipe Santiago. Sam decides to keep the store open until midnight during the week. If the additional hours bring in customers and increase profits, Sam may be praised by Felipe. He may even get a raise. However, Sam won't directly receive any of the profits because he is an employee. The additional earnings will flow to Felipe, the owner.

Why Do People Become Entrepreneurs? People go into business for themselves for many reasons. Some want to leave the fast-paced corporate environment and set their own schedules. Others want to be at home but still earn an income. Still others want to pursue a personal dream. You might choose to become an entrepreneur for completely different reasons.

Integrity and Ethical Behavior. An important part of being an entrepreneur involves operating with integrity and exhibiting ethical behavior in all areas of business. Ethical business practices by entrepreneurs ensure that the highest standards of conduct are observed in their relationships with everyone affected by the business's activities. When operating with integrity, entrepreneurs behave consistently in actions, values, methods, measures, principles, expectations, and outcomes. When considering whether or not behavior is ethical, both the actions taken by the entrepreneur and the results of those actions should be considered.

RECOGNIZING OPPORTUNITY

Many of America's most successful companies started with one person who recognized an opportunity and came up with an idea for a business in response to that opportunity. Entrepreneurs have played an important role in the history of America's economy and will continue to shape our economy in the future. According to estimates from the U.S. Small Business Administration's Office of Advocacy, there are approximately 29.6 million businesses in the United States. Small firms with fewer than 500 employees represent 99.9 percent of these 29.6 million businesses in the United States. Only 18,000 U.S. businesses are considered large. Small businesses contribute billions of dollars to the U.S. economy every year and generate jobs that drive economic growth. According to the National Small Business Association, small businesses created 21.9 million jobs in the last 15 years compared with 1.8 million jobs created by large businesses. These small businesses are found in virtually every sector of the economy.

ENTREPRENEURS WHO CHANGED AMERICA

Entrepreneurs change American business decade after decade. They establish new companies and fill unmet needs. They continuously change how things are done and contribute to the overall good of the nation. There are many businesses today that started small and have grown into large companies that are making a major impact in our economic system.

Starbucks Coffee Company. Starbucks Coffee Company was founded in 1971, opening its first location in Seattle's Pike Place Market. Starbucks is named after the first mate in Herman Melville's novel Moby Dick. It is the world's leading brand of specialty coffee. Its stores receive more than 40 million customer visits per week at coffeehouses in North America, Europe, the Middle East, Latin America, and the Pacific Rim. When Howard Schultz first joined the company in the early 1980s, Starbucks was already a highly respected local roaster and retailer of whole bean and ground coffees. A business trip to Italy, where he was impressed with the popularity of espresso bars in Milan, helped Schultz recognize an opportunity to develop a similar coffee-house culture in Seattle. Espresso drinks became an essential element of Schultz's vision. He purchased Starbucks with the support of local investors in 1987. In addition to its well-situated coffeehouses, Starbucks markets its coffee and tea products through its website and through many national retail supermarkets.

The Home Depot. In 1979, Bernie Marcus and Arthur Blank opened the first two The Home Depot stores in Atlanta, Georgia, forever changing the home improvement industry. They envisioned a home improvement store that offered one-stop shopping for the do-it-yourselfer. The original stores stocked around 25,000 products. An average store today offers 40,000 products in approximately 105,000 square feet. Marcus and Blank's vision was of warehouse stores filled from floor to ceiling with a wide assortment of home improvement products at the lowest prices and with the best possible service. Within five years, The Home Depot expanded from Georgia to Florida, Louisiana, Texas, and Alabama. Today, it has more than 2,100 stores in the United States, Canada, and Mexico.

HARPO Productions, Inc. Oprah Winfrey's love of acting and her desire to bring quality entertainment projects into production prompted her to form her own production company, HARPO Productions, Inc., in 1986. Today, HARPO is a formidable force in film and television production. Based in Chicago, HARPO Entertainment Group includes HARPO Productions, Inc., HARPO Films, and HARPO Video, Inc. In October 1988, HARPO Productions, Inc., acquired ownership and all production responsibilities for The Oprah Winfrey Show from Capitol Cities/ABC, making Oprah Winfrey the first woman in history to own and produce her own talk show. The following year, HARPO produced its first television miniseries, The Women of Brewster Place, with Oprah Winfrey as star and executive producer. Oprah also produced and appeared in several television miniseries and movies.

ENTREPRENEURIAL OPPORTUNITIES IN ECONOMIC RECOVERY

Even during downturns in the economy, entrepreneurial opportunities still exist. While big businesses tend to be more conservative in their approach to economic slowdowns by scaling back production, conserving cash, and laying off workers, small businesses that have less to lose are more willing and able to make changes quickly. They can be more creative and take more risks than large companies. Their experimentation and innovation lead to technological change and increased productivity. This makes small businesses a significant part of the economic recovery process.

The American Recovery and Reinvestment Act of 2009 was passed to stimulate the American economy after the 2008 economic slowdown. It supported a number of provisions to help small businesses, including $30 billion in tax relief for small businesses and $13 billion in loans, lines of credit, and equity capital. Other provisions included:

- Increasing the Small Business Administration (SBA) guarantee on loans up to 95 percent of loan value
- Improving the liquidity of small business lending markets
- Allowing the SBA to refinance existing loans, including those with both the SBA and other lenders
- Increasing equity capital for high-growth businesses
- Providing lending assistance for borrowers locked out of traditional financing markets
- Offering tax relief in several forms

This stimulus package also contained significant new support to increase green businesses, including incentives to drive the growth of renewable energy, stimulate energy efficiency efforts, and update the nation's electrical grid.

BUSINESS SUCCESS OR FAILURE

Although there are many opportunities for entrepreneurial success, there is also a risk of failure. According to a recent study by the Small Business Administration's Office of Advocacy, 67 percent of new businesses survive at least two years, and 44 percent survive at least four years. This means that more than half of all new businesses do not survive beyond four years. These results are similar for different industries. Many people think that there is a higher failure rate for restaurants than for other types of businesses. However, leisure and hospitality establishments, which include restaurants, survive at rates only slightly below the average. Major factors in a firm's success include having adequate capital and being large enough to have employees. The owner's education level and reason for starting the firm in the first place, such as freedom for family life or wanting to be one's own boss, are also important factors. The reason must sufficiently motivate the entrepreneur to have the perseverance to succeed.

The owner's business experience is a factor that contributes to the likelihood of success. Experienced businesspeople have an understanding of how to purchase products and services. They know how to plan, negotiate with suppliers, raise money, negotiate leases, sell and market their product or service, and manage finances. Many businesses fail because the owner lacks business knowledge. Someone may have an idea for a product or service but may lack the necessary business skills he or she needs to run a successful business. There is a major difference between having expertise regarding a product or service and running a business with that product or service. So when opportunity presents itself, entrepreneurs must have what it takes to succeed.

1-2 Characteristics of an Entrepreneur

OBJECTIVES

- ***Identify the characteristics of successful entrepreneurs.***
- ***Identify the characteristics of good team members.***
- ***Assess whether you have what it takes to succeed in your own business.***

CHARACTERISTICS OF SUCCESSFUL ENTREPRENEURS

Many people dream of running their own businesses. They would like to become entrepreneurs. Entrepreneurship can be exciting, but many go into it not realizing how difficult it is to run their own business. In fact, statistics show that most new businesses will fail within a few years. These startup businesses fail because of the owner's poor planning, lack of business knowledge, lack of entrepreneurial characteristics, inability to work with others, or failure to choose the right business.

Researchers have identified several characteristics that distinguish successful entrepreneurs from those that fail:

1. Successful entrepreneurs are **independent**. They want to make their own decisions and do something they enjoy.
2. Successful entrepreneurs are **self-confident**. Entrepreneurs make all the decisions. They must have the confidence to make choices alone and bounce back from a poorly made decision.
3. Successful entrepreneurs have **determination and perseverance**. Entrepreneurs persist through hard times until goals are met.
4. Successful entrepreneurs are **goal-oriented**. They know what they want, and they are able to focus on achieving it.
5. Successful entrepreneurs have **a need to achieve and to set high standards for themselves**. They are motivated by setting and achieving challenging goals.
6. Successful entrepreneurs are **creative**. They think of new ways to market their businesses and are always looking for new solutions to problems.
7. Successful entrepreneurs are **able to act quickly**. They are not afraid to make quick decisions when necessary, which helps them beat their competitors.
8. Successful entrepreneurs **keep up to date with technology**. New technologies emerge that can help with many business activities. In order to run their business efficiently, entrepreneurs should always be on the lookout for new technology they can apply to their business.

Ryan Nelson has many entrepreneurial characteristics. Since he was 14, Ryan played for his high school basketball team. Other boys his height – just 5' 8" – would not have enjoyed competing with much taller boys. Ryan accepted that he would have to work harder to win. He needed to be creative in handling the ball. Most of all, he had to believe in himself. He did, and he became one of the top players on his team. If Ryan opened his own business, the characteristics he displayed as a ball player might help him succeed.

CHARACTERISTICS OF GOOD TEAM MEMBERS

Entrepreneurs realize that there are other stakeholders in their businesses- partners, investors, employees, suppliers, customers, creditors, and so forth. They must work with others to get their business up and running. They must have good team-building skills as well as be effective team members. Good team members display the following traits:

1. **Commitment**. They are committed to team goals and are willing to work hard to achieve the goals.
2. **Competency**. They have the right set of skills needed to get the job done and to help accomplish the team's goals.
3. **Communication**. They have good communication skills and can share ideas with others in both oral and written form.

4. **Cooperation**. They work well with others and know that they will not always get their way. They are willing to accept the decision of the group for the good of the group.
5. **Creativity**. They are able to look at things from different perspectives and suggest new ways of doing things.

Ryan Nelson displayed these traits as a member of his basketball team. He competed as a team player, recognizing that every member of the team contributed to its success. His experience will help him work effectively as part of a team in the business world. If Ryan becomes an entrepreneur, he could apply these skills when working with other people who will be important to his success.

ARE YOU RIGHT FOR ENTREPRENEURSHIP?

Entrepreneurship is not for everyone. Some people lack the qualities needed to become successful entrepreneurs. Others lack the aptitude needed to run a business. For others, the advantages of entrepreneurship do not outweigh the disadvantages.
To determine if entrepreneurship is right for you, you first need to perform a self-assessment. A self-assessment is an evaluation of your strengths and weaknesses. You can do this in a number of ways. You can list what you believe to be your strengths and weaknesses on a sheet of paper. You can ask others what they believe your strengths are and where your weaknesses lie. There are also professional tests you can take to assess your abilities.

Assess Your Interests

Success as an entrepreneur requires a strong commitment to a business and a lot of energy. To be able to commit yourself fully to a business, you should choose a field that interests you and that will provide you with an experience you will enjoy. Many entrepreneurs center a business on an interest or hobby. Analyzing past experiences and jobs can also help. Have you had any jobs or experiences that you found fulfilling? Perhaps building a business around that activity could lead to success.

Assess Your Aptitude

Different jobs require different job aptitudes. Aptitude is the ability to learn a particular kind of job. Auto mechanics must possess an aptitude for solving mechanical problems. They must also be good with their hands. People who sell insurance must have good interpersonal skills. Answering questions like those in the Job Attributes Checklist can help you identify the kinds of entrepreneurial opportunities that might match your aptitudes and interests.

JOB ATTRIBUTES CHECKLIST

- ❑ 1. I enjoy working with numbers.
- ❑ 2. I enjoy working outdoors.
- ❑ 3. I enjoy working with my hands.
- ❑ 4. I enjoy selling.
- ❑ 5. I like working with people.
- ❑ 6. I prefer to work alone.
- ❑ 7. I like supervising other people.
- ❑ 8. I like knowing exactly what I am supposed to do.

Assess the Advantages of Entrepreneurship

Many people see significant advantages in owning their own businesses. Some of the biggest advantages include the following:

- Entrepreneurs are their own bosses. Nobody tells an entrepreneur what to do. Entrepreneurs control their own destinies.
- Entrepreneurs can choose a business that interests them. Entrepreneurs work in fields that interest them. Many combine hobbies and interests with business.
- Entrepreneurs can be creative. Entrepreneurs are always implementing creative ideas they think of themselves.
- Entrepreneurs can make large sums of money. Entrepreneurship involves risk, but if the business is successful, the business owner will reap the profits.

Assess the Disadvantages of Entrepreneurship

As the disadvantages show, entrepreneurship is not for the faint of heart. All prospective entrepreneurs must weigh the advantages and disadvantages before making the decision to start a business. Disadvantages include the following:

- Entrepreneurship is risky. Just as there is the chance to earn large sums of money, there is the possibility of losing money and going out of business.
- Entrepreneurs face uncertain and irregular incomes. Entrepreneurs may make money one month and lose money the next.
- Entrepreneurs work long hours. Entrepreneurs are never really finished with their jobs. They can work long, irregular hours. They receive no paid days off and often work evenings and weekends.
- Entrepreneurs must make all decisions by themselves. Unless they have partners, entrepreneurs have the final responsibility for all decisions that are made regarding the business.

1-3 Explore Ideas and Opportunities

OBJECTIVES

- ***Identify sources for new business ideas.***
- ***Recognize different business opportunities.***
- ***Identify your own personal goals.***

LOOK FOR IDEAS

Millions of entrepreneurs in the United States start their own businesses. You may wonder how they decided what businesses to operate. They may have acted on a new idea or an opportunity. An idea is different from an opportunity. Opportunities are possibilities that arise from existing conditions. Ideas are thoughts or concepts that come from creative thinking. Ideas can come from many different sources.

HOBBIES AND INTERESTS

Many people get business ideas from their hobbies or interests. Making a list of hobbies and interests can help you decide what business is right for you. Bill had always enjoyed working with his grandfather on the farm and had helped to build and maintain many farm structures. He built a garage and added a sunroom to his own home. He also was able to make plumbing, electrical, and carpentry repairs around the house. He started doing this for others in his spare time. Soon he had so many people calling on him for these services that he decided to start a general contracting business.

PAST EXPERIENCES

Analyzing past experiences and jobs can help you come up with ideas for a business you would enjoy owning. People who excel at their jobs have generally learned much about their profession and how to satisfy customer needs. They also see how successful marketing is conducted. Through their work, they can build a network of potential customers, suppliers, employees, and distributors. When they feel confident that they can offer a product or service to this market more effectively than their current employer, they can start a new business. The experience and training they received on the job will increase their chances of success in running a new business. Samantha Rodriguez worked as a computer network administrator for a large company. Recognizing that she could use her experience to perform the same computer services for other companies, Samantha started her own computer consulting service. She currently earns less money than she did working for a large company, but she enjoys working flexible hours and meeting new people.

DISCOVERY OR INVENTION

Sometimes a business opportunity arises from a discovery or invention. Someone may invent a new tool that works better than tools that are currently available. The next step would be to research and find out if the idea can be patented, who the competition is, what the manufacturing process would be, and who the target market is. Chandra enjoyed working in her garden, but she did not like any of the tools she had for removing weeds from around the plants. She took one of her tools and made modifications to it and found that it worked perfectly. After several friends tried out the tool and liked it, Chandra decided to investigate how to market and sell her invention.

INVESTIGATE OPPORTUNITIES

People often conduct research to determine what is missing in a particular market-what needs exist that are not being met. By doing this research, they hope to find the perfect business opportunity.

SOURCES OF INFORMATION

The Internet and the library have resources that can help you conduct research for different opportunities. These include books on entrepreneurship, magazines for entrepreneurs, trade magazines for certain businesses, and government publications. County Business Patterns is an annual series of publications providing economic profiles of counties, states, and the country as a whole. Data include employment, payroll, and the number of establishments by industry. The Internet and the library are not the only places to investigate opportunities. The Small Business Administration (SBA) is an organization that exists to help small businesses and their owners. It publishes helpful information. Talking to entrepreneurs and attending trade shows, which are special meetings where companies of the same industry or related industries display their products, can also be beneficial. Luanda Williams wanted to use her love of sports and dancing to create her own company. She found books and magazine articles at the library that gave her information on various kinds of businesses. She also talked to owners of gymnastic centers, health clubs, and dance studios. She discovered that there were not enough children's fitness programs to meet the demand in her area. Her research revealed the many opportunities available in the children's fitness industry.

COMPARE DIFFERENT OPPORTUNITIES

Once you find appealing business opportunities, you need to identify which ones have the best chance for success. Now is the time to assess each business opportunity by asking yourself the following questions:

1. Is there a market in my community for this kind of business? Will people buy my product or service?
2. How much money would it take to start this business? Will I be able to borrow that much money?
3. How many hours a week is it likely to take to run this business? Am I willing to commit that much time?
4. What are the risks associated with this business? What is the rate of business failure?
5. Does my background prepare me to run this kind of business? Do most people who own this kind of business have more experience?
6. How much money could I make running this business?

SET GOALS

For everything you do in life, you set goals. Goals help you stay on track and follow through with your plans. The best goals are SMART. SMART goals provide more direction, as shown below.

SMART GOALS	
Specific	Goals should be specific and answer "What?" "Why?" and "How?"
Measurable	Goals should establish ways to measure your progress.
Attainable	Goals should not be too far out of reach.
Realistic	Goals should represent things to which you are willing to commit.
Timely	Goals should have a timeframe for achievement.
Goal	I will learn more about starting my own business.
SMART Goal	I will learn more about starting my own catering business by obtaining information from the Small Business Administration and talking with the owners of three local catering businesses by the end of the month.

As an entrepreneur, you will need to set many goals. Goals can be categorized as financial and nonfinancial.

Financial Goals

Set specific financial goals before starting a business. Financial goals can include how much money you will earn and how quickly you will pay off debts. Make sure your goals are realistic. If one of your goals is to make large sums of money early on, you almost certainly will be disappointed. It usually takes time for businesses to become well established and profitable. Setting SMART financial goals will help you develop a realistic plan for earning a profit. Goals should be measurable and easily attainable in the time allotted. Mo Yang wants to start a mail-order business for model trains, planes, and cars. His income goal is to earn $27,000 by the end of the first year. He estimates that after expenses he will earn $9 for each item he sells. At this rate of profit, he would have to sell 3,000 models to meet his income goal. Mo realizes that this is not realistic. He would have to lower his income goal or find another business idea.

Nonfinancial Goals

Most people who own their own businesses do so for more than just monetary gain. They are looking for personal satisfaction. They may serve a community need, do something they like, or enjoy the personal independence. You will want to specify what nonfinancial goals you want to achieve by being an entrepreneur. For example, as a business owner, you may want to offer support to a charity organization, either by making monetary donations or by offering your business's services. Setting and meeting nonfinancial goals can help an entrepreneur live a more satisfying and fulfilling life.

1-4 Why a Business Plan Is Important

OBJECTIVES

- ***Explore the purposes of a business plan.***
- ***Identify the types of business plans and the parts commonly found in a business plan.***

PURPOSE OF A BUSINESS PLAN

Creating a business could be one of the most important things you do in your life. So it would only make sense to spend time planning it. Most entrepreneurs initially develop a business plan as a way of describing their business precisely. A business plan is a statement of your business goals, the reasons you think these goals can be met, and how you are going to achieve them. If you start your business without a plan, you will soon be overwhelmed by questions you haven't answered. A business plan forces you to figure out how to make your business work. A well-written business plan will show investors that you have carefully thought through what you intend to do to make the business profitable. The more explanation you offer investors about how their money will be used, the more willing they will be to invest. Your plan should be so thoughtful and well written that the only question it raises in an investor's mind is "How much can I invest?"

A well-written plan will also guide you every step of the way as you develop your business. It becomes a decision-making tool. An entrepreneur uses the business plan to track whether the company is meeting its goals. From time-to-time, the business plan needs to be revised to keep up with the changing nature of the business. Some business owners might do this on an annual basis; others, in well-established industries, might do it every three years. Still others, in newly developed or high-tech areas, may need to do it monthly or even weekly.

TYPES OF BUSINESS PLANS

Business plans have no set format. A plan is developed based on the type of business that is intended. However, it is also based on the audience. Businesses need different types of plans for different audiences. There are three main types of plans for a start-up business:

Quick Summary. This is a brief synopsis lasting no more than thirty seconds to three minutes. It's used to interest potential investors, customers, or strategic partners. It may seem strange to consider this a type of business plan, but it is. Some people call this an “elevator pitch”.

PowerPoint Business Plan. This is an informative, colorful, and entertaining slide show with a running narrative. It is meant to interest potential investors in reading the detailed business plan. Often, you will hear people refer to this as a “Pitch Deck”, since it is used to pitch your business to potential investors and partners.

Formal Business Plan. Anyone who plans to invest in your start-up business (banks, investors, and others) needs to know exactly what you are planning. They need a detailed business plan that is well written and formatted so all the information can be easily understood. When entrepreneurs talk about a business plan, this is typically the type of plan they mean.

Although there is no set format for a business plan, each plan will address “The 3 Cs” of Business Plans:
- Concept. What is your product or service and how is it different from similar products or services?
- Customer. Who will be buying your product or service and why?
- Capital. How will you locate the initial money your business will need? What will be your costs and what kind of profit can you expect?

PARTS OF A BUSINESS PLAN

In this course you will become experienced in developing all three types of business plans. Bankers and other professional investors need to see your business plan before they lend you money. You may have a brilliant idea, but if you do not explain it carefully in a well-written business plan, no professional investor will be interested.

Most plans will include these seven parts (although the order may differ):

1. **Description** (overview of the business idea)
2. **Objectives** (what problem is the business solving and what makes the business different)
3. **Business Strategies** (strategies for starting up the business and being successful)
4. **Products and Services Provided** (detailed description of the products and services)
5. **Management Structure** (ownership structure, management, and employees)
6. **Market Analysis** (market, competition, and marketing plan)
7. **Financial Analysis** (start-up costs and projected financial statements)

PUTTING YOUR PLAN TOGETHER

You will be putting together your own business plan. In the process, you may discover that what you thought was a good business opportunity is not quite the opportunity you thought. You might need to abandon the idea or tweak it to make it more viable. It is better to discover that the business won't work on paper before you invest significant time and money.

Developing a business plan is not a simple, straightforward process. You don't start at the beginning and move to the end. Each new piece of information or financial calculation could cause you to reexamine, and possibly change, everything you have done up to that point.

1-5 Entrepreneurs Satisfy Needs and Wants

OBJECTIVES

- ***Distinguish between needs and wants.***
- ***Describe the types of economic resources.***
- ***Explain the roles of entrepreneurs in the U.S. economy.***

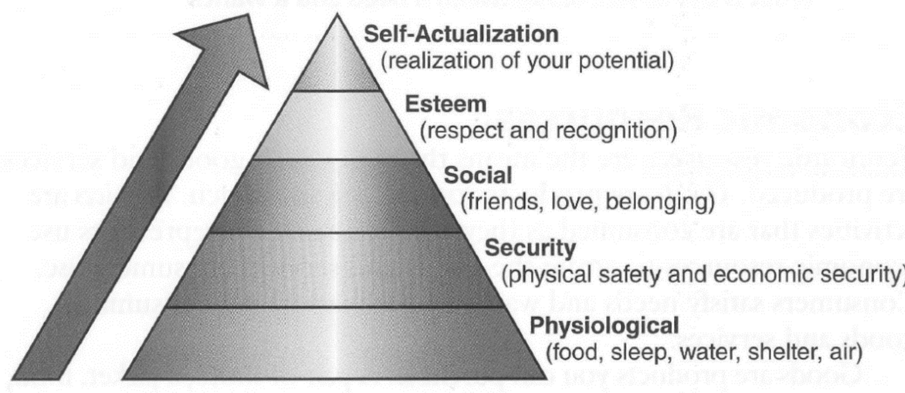
IS IT A NEED OR A WANT?

Think about your favorite piece of clothing, such as a pair of jeans. First, you thought about what type of clothing you wanted, and then you went out and found it. Maybe you looked at several articles of clothing and compared prices before you decided to spend your money. If someone else gave you clothing as a gift, then that person had to think about what you might like and then make a choice. Economics is all about making choices and satisfying the wants and needs of consumers.

Do you know the difference between your needs and wants? Your needs are things that you must have in order to survive. Needs include food, basic clothing, and a place to live. Your wants are those things that you think you must have in order to be satisfied. Wants add comfort and pleasure to your life. Wants would include things like cell phones, computers, and jewelry. The role of businesses is to produce and distribute goods and services that people need and want.

NEEDS

People have many needs. Some are basic needs while others are higher-level needs. Abraham Maslow was a psychologist who developed a theory on the hierarchy of needs. It identifies five areas of needs-physiological, security, social, esteem, and self-actualization needs. The theory suggests that people's basic physiological needs, such as food, clothing, and shelter, must be satisfied first before they can focus on higher-level needs. Once basic needs are met, people will try to satisfy their security needs. When these needs are filled, individuals turn their attention to social needs, such as friendship. Esteem needs can be satisfied by gaining the respect and recognition of others. Self-actualization needs usually involve something that provides a sense of accomplishment, such as earning a college degree.



Maslow's Hierarchy of Needs Pyramid

Beyond basic needs, not all people have the same needs. Needs depend on a person's situation. You may live in a nice house in a gated community, so your security needs are met. Someone who lives in a high-crime area still may be trying to meet security needs. Wants Individuals have two different types of wants – economic wants and noneconomic wants. Economic wants involve a desire for material goods and services. They are the basis of an economy. People want material goods, such as clothing, housing, and cars. They also want services, such as hair styling and medical care. No economy has the resources necessary to satisfy all of the wants of all people for all material goods and services. The goods and services that people want must be produced and supplied.

People also have noneconomic wants, or the desire for nonmaterial things. These wants would include such things as sunshine, fresh air, exercise, friendship, and happiness.

NEEDS AND WANTS ARE UNLIMITED

Your needs and wants never end. You are limited only by what your mind can think of and what businesses make available for sale. If you are going camping, you might need to buy a tent for shelter. One purchase often leads to another. After buying a tent, you might also want to buy other camping supplies. Then you might want a bigger backpack to carry your new supplies.

ECONOMIC RESOURCES

Economic resources are the means through which goods and services are produced. Goods are products you can see and touch. Services are activities that are consumed as they are produced. Entrepreneurs use economic resources to create the goods and services consumers use. Consumers satisfy needs and wants by purchasing and consuming goods and services.

Goods are products you can purchase. A pair of shoes, a jacket, food, and cars are all examples of goods. Services must be provided to you at the time you need them – they cannot be stored. A haircut, a manicure, lawn mowing, and car detailing are all examples of services.

FACTORS OF PRODUCTION

In order to create useful goods and services, an entrepreneur may use three types of economic resources. These resources are called the factors of production and include natural resources, human resources, and capital resources.

Natural Resources. Raw materials supplied by nature are natural resources. The earth contains oil, minerals, and the nutrients needed to grow crops and timber. Rivers, lakes, and oceans are the sources of both food and water. All products you use begin with one or more natural resources. The supply of many natural resources is limited. Increased use of natural resources and damage to the environment threatens the continued availability of natural resources in many regions of the world. Conservation practices and the production of more efficient products help to preserve and renew resources.

Human Resources. The people who create goods and services are called human resources. They may work in agriculture, manufacturing, distribution, or retail businesses. As an entrepreneur, you would also be a human resource. Entrepreneurs have creative ideas and use these ideas to create new goods and services. To increase the productivity of human resources, business owners may use specialization and division of labor. Specialization occurs when individual workers focus on single tasks, enabling each worker to become more efficient and productive. Even though a worker may be talented at many things, when he or she specializes in performing one task, generally, more can be produced. Division of labor divides the production process into separate tasks carried out by workers who specialize in those specific tasks. This division of labor allows the group as a whole to be more productive.

Capital Resources. The assets used in the production of goods and services are called capital resources. Capital resources include buildings, equipment, and supplies. They also include the money needed to build a factory, buy a delivery truck, and pay the employees who manufacture and distribute goods and services.

LIMITED RESOURCES

All economic resources have a limited supply. Most resources can be used to produce several different products and services. If resources are used to produce one type of product, they may not be available for the production of another product. Individuals, businesses, and countries compete for access to and ownership of economic resources. Those resources that are in very high demand or that have a limited supply will command high prices.

LAW OF DIMINISHING RETURNS

To make the most efficient use of their resources, businesses should consider the law of diminishing returns. The law of diminishing returns states that if one factor of production is increased while others stay the same, the resulting increase in output (product produced) will level off after some time and then will decline. This means that extra workers, extra capital, extra machinery, or extra land may not necessarily raise output as much as expected. For example, increasing the number of workers (human resources) may allow additional output to be produced by using any spare capacity workers have, such as unused workspace or machinery (capital resources). Once this capacity is fully used, however, continually increasing the number of workers without increasing the workspace or number of machines will not result in an increase of output.

ROLE OF ENTREPRENEURS IN THE U.S. ECONOMY

Entrepreneurs play an important role in the U.S. economy. Because all businesses that exist in the United States today began as an entrepreneurial idea, you could say that entrepreneurs are the backbone of the U.S. economy. The development and growth of small businesses help to ensure a strong economic future.

SUPPLY AND DEMAND

As business owners, entrepreneurs play an important role in supplying goods and services to meet the demands of consumers. They continually look for unmet needs or better ways to satisfy consumers' needs and wants. They use resources and their knowledge of markets and business to produce goods and services efficiently that meet consumers' needs and wants.

CAPITAL INVESTMENT AND JOB CREATION

Entrepreneurs need money to finance their businesses. Sometimes they use their own money. Other times, they look to investors and lenders to supply the money they need. They may use the money to lease a building, buy equipment, or hire employees. By doing so, entrepreneurs are investing in their communities by contributing to the local economy and providing jobs.

CHANGE AGENTS

Many entrepreneurs create products that change the way people live and conduct business. When you learn about American history, you see that many entrepreneurs have shaped the U.S. economy.

1-6 Types of Entrepreneurial Businesses

OBJECTIVES

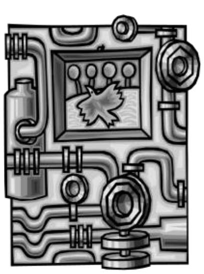
- ***Identify the types of entrepreneurial businesses.***
- ***Explore the characteristics of each type of business.***

TYPES OF ENTREPRENEURIAL BUSINESSES

There are generally four types of businesses, and there are many opportunities for entrepreneurs in each type. Manufacturing businesses actually produce the products they sell. Using resources and supplies, they create everything from automobiles to paper. Wholesaling businesses sell products to other businesses rather than the final consumer. For example, a wholesaler supplies your local greeting card store with items such as cards and wrapping paper. Retailing businesses, such as the greeting card store, sell products directly to the people who use or consume them. Service businesses sell services rather than products. They include hotels, hairdressers, and repair shops, to name a few. Two other categories of businesses are (1) agricultural and (2) mining and extracting businesses. Agricultural businesses generate fresh produce and other farm products, such as wheat. Mining and extracting businesses take resources like coal out of the ground so that they can be consumed.

TYPES OF BUSINESSES			
Manufacturing	Wholesaling	Retailing	Service
Apparel and other textile products	Apparel	Auto and home supply stores	Appliance repair
Chemicals and related products	Electrical goods	Building materials and supply stores	Automotive repair
Electronics and other electrical equipment	Groceries and related products	Clothing stores	Babysitting
Fabricated metal products	Hardware, plumbing, heating equipment	Florists	Bookkeeping
Food products	Lumber, construction materials	Furniture stores	Consulting
Industrial machinery and equipment	Machinery, equipment, supplies	Gift, novelty, and souvenir stores	Dance instruction
Printing and publishing	Motor vehicles, automotive equipment	Grocery stores	Electrical services
Rubber and miscellaneous plastic products	Paper, paper products	Hardware stores	Exterminators
Stone, clay, and glass products	Petroleum, petroleum products	Jewelry stores	Flower decorating
		Retail bakeries	House cleaning
		Shoe stores	Lawn care
		Sporting goods and bicycle stores	Painting
			Plumbing
			Translating
			Travel agency
			Tutoring
			Web design and maintenance

MANUFACTURING BUSINESSES



A manufacturing business (manufacturer) converts materials into goods suitable for use and then sells those goods to others. Manufactured products typically fall into two categories: industrial and consumer. Industrial goods are sold to other manufacturing businesses. Examples include metal and plastic parts, lumber, and heavy machinery. Consumer goods are products that are eventually bought by the public. Small manufacturing businesses that produce consumer goods sometimes sell directly to the public. For example, entrepreneurs making baked goods, silk-screened T-shirts, or jewelry most often sell their products directly to consumers. Large manufacturing businesses usually do not sell directly to consumers; they may sell to wholesalers.

WHOLESALING (OR DISTRIBUTOR) BUSINESSES

A wholesaling business (or distributor) buys goods in large quantities, typically from manufacturers, and resells them in smaller batches to retailers. Wholesalers are also known as middlemen, go-betweens, distributors, or intermediaries because they provide a link between manufacturers and retailers, who sell goods to consumers. Wholesalers do not generally sell directly to the public.

RETAILING BUSINESSES

A retailing business (retailer) buys goods, often from wholesalers, and resells them directly to consumers, who are the end buyers. Retailing businesses are stores, shops, and boutiques. They sell groceries, clothing, shoes, household goods, computers, sporting goods, cosmetics, jewelry, and thousands of other consumer items directly to end buyers. Retailing businesses include traditional stores that people visit in person and online stores that sell from the Internet. Some retailers also sell through catalogs. In most states retailers must have a special permit (often called a reseller's permit) to purchase goods tax-free from wholesalers and collect sales tax from the end buyers.

A business that is either a wholesale or retail business is commonly referred to as a trade business.

SERVICE BUSINESSES

A service business provides services to customers for a fee. Service businesses provide a wide variety of professional, technical, and everyday services that people need and want. Examples include engineering, legal, medical, accounting, garbage pick-up, package delivery, dry cleaning, auto repair, babysitting, pet sitting, music lessons, tutoring, house cleaning, and landscaping. Most states and some local governments have licensing requirements for people who provide particular services. This applies to professionals (doctors, dentists, engineers, lawyers, and so on) as well as other types of service providers, such as hairstylists, dog walkers, automobile mechanics, athletic trainers, and daycare providers. In addition, some states require service businesses selling taxable services to have a permit to collect sales tax from their customers.

SPECIAL TYPES OF BUSINESSES

Farming is a special type of business. Sometimes it is more like manufacturing (if the agricultural products are used to create new products, as when grain is used to make bread). Farming is a combination of manufacturing and retailing when fruits or vegetables are sold directly to the consumer. Mining is another special type of business. Often referred to as an "extraction business," mining takes resources from the environment and converts them into a form that can typically be sold to manufacturers. Examples of extraction businesses are copper mining, oil drilling, and converting sea salt to table salt.

BUSINESSES OF THE FUTURE

The North American Industry Classification System (NAICS) assigns a numerical code to every industry in North America based on its primary business function. NAICS codes are useful for classifying particular types of businesses. The U.S. Department of Labor makes predictions on which industries will likely experience the largest growth in number of employees in the following decade. The top ten companies have one thing in common: they provide some type of service. This demonstrates that service businesses are expected to dominate the U.S. economy through 2020.

Fastest-Growing Industries

Rank	Industry	NAICS #
1	Management, scientific, and technical consulting services	5416
2	Individual and family services	6241
3	Home health-care services	6216
4	Financial investments and related services	523
5	Facilities support services	5612
6	Residential care facilities and related services	6232, 6233, 6239
7	Independent artists, writers, and performers	7115
8	Computer-systems design and related services	5415
9	Museums, historical sites, and similar institutions	712
10	Child daycare services	6244

1-7 Choose a Form of Business

OBJECTIVES

- ***Explore the advantages and disadvantages of purchasing an existing business, starting a franchise, joining a family business, or starting a new business.***
- ***Explore the advantages and disadvantages of establishing your business as a sole proprietorship, partnership, or corporation.***

DECIDE TO PURCHASE, JOIN, OR START A BUSINESS

There are many ways to go into business, including purchasing an existing business, starting a franchise, joining a family business, or starting a new business.

PURCHASE AN EXISTING BUSINESS

When most people consider going into business for themselves, they think about starting a new business. But purchasing an existing business could be a good option. Owners sell their businesses for a variety of reasons. Reasons can include insufficient sales or profits, new competition, fear of changing economic conditions, retirement, a dispute among partners, death or illness of a partner, and the owner's desire to do something different. There are many ways to find businesses that are for sale. You may find advertisements in the local newspaper. You might decide to use a business broker who sells businesses for a living. Other people in your industry might know of businesses for sale. You might also learn about available businesses through leasing agents, lawyers and bankers, management consultants, the Small Business Administration, the Chamber of Commerce, and bankruptcy announcements.

Advantages of Buying an Existing Business

There are many advantages to buying an existing business.

- The existing business already has the necessary equipment, suppliers, and procedures in place. It may also have built up goodwill, or customer loyalty. You may want to change some of the policies and procedures established by the former owner, but fine-tuning existing systems is likely to be much easier than creating systems from scratch.
- The seller of a business may train a new owner. The previous owner or experienced employees may be willing to help the new owner learn about the company.
- There are prior records of revenues, expenses, and profits. This means that financial planning will be easier and more reliable than it would be for a completely new business.
- Financial arrangements can be easier. The seller of the business may accept an initial partial payment and allow the rest to be paid off in monthly installments. If bank financing is needed, getting it may be easier because banks are more likely to lend to an established business.

Disadvantages of Buying an Existing Business

Buying an existing business sounds like an easy way to become an entrepreneur, but it can be risky. There are disadvantages.

- Many businesses are for sale because they are not making a profit. Owners often try to sell businesses that are not financially profitable.
- Serious problems may be inherited. Businesses can have poor reputations with customers, have trouble with suppliers, be poorly located, or have other problems that may be difficult to overcome.
- Capital is required. Many new entrepreneurs just do not have the money to purchase a mature business. Starting small may be their only option.

FRANCHISE OWNERSHIP

Purchasing a franchise is another route by which you can become an entrepreneur. A franchise is a legal agreement that gives an individual the right to market a company's products or services in a particular area. A franchisee is the person who purchases a franchise agreement. A franchisor is the person or company that offers a franchise for purchase. More than 909,000 franchises are operating in the United States, and the number is growing. Franchising opportunities are available in virtually every field, from motels to pet stores to restaurants. If you decide to purchase a franchise, you will have to pay an initial franchise fee, startup costs, royalty fees, and advertising fees.

Advantages of Owning a Franchise

When deciding whether to buy a franchise, you should also consider the advantages and disadvantages of it. There are four main advantages.

- An entrepreneur is provided with an established product or service. This allows entrepreneurs to compete with large, well-known companies.

- Franchisors offer management, technical, and other assistance. This may include onsite training or classes, aid with starting the new business and handling daily operations, and tips on crisis management. Some franchisors even offer help on everything from site selection and building design to equipment purchase and recipes. Most also maintain toll-free telephone numbers that franchisees can call for advice.
- Equipment and supplies can be less expensive. Large franchises may be able to purchase in huge quantities. Some of the savings they enjoy as bulk purchasers are passed on to the franchisee.
- A guarantee of consistency attracts customers. A franchise contract mandates a certain level of quality. Consumers know that they can walk into a franchise anywhere in the country and receive the same product or service. The cheeseburger sold at a Wendy's in Long Beach, California, will be very similar to the cheeseburger sold in Toledo, Ohio.

Disadvantages of Owning a Franchise

Although franchising sounds like a great idea, there are some disadvantages that you need to consider.

- Franchise fees can be costly and cut down on profits. The initial capital needed to purchase a franchise business often is high. Also, some of the profits you earn as a franchise owner are returned to the franchisor as royalty fees.
- Owners of franchises have less freedom to make decisions than other entrepreneurs. Many business decisions that entrepreneurs generally make themselves have already been made for franchisees. Franchisees must offer only certain products or services, and they must charge prices set by the franchisor. Many entrepreneurs object to this control because it inhibits the freedom they sought as independent business owners.
- Franchisees are dependent on the performance of other franchisees in the chain. A franchisee can benefit from the success of other franchisees. But if other franchisees run sloppy operations, customer opinions of the chain will decline. As a result, customers may stop going to a franchise, even if a particular store maintains high standards.
- The franchisor can terminate the franchise agreement. If the franchisee fails to pay royalty payments or meet other conditions, the investment in the franchise can be lost. Similarly, when the franchise expires, the franchisor can choose not to renew the agreement.

ENTER A FAMILY BUSINESS

The U.S. economy is dominated by family businesses. According to some estimates, as many as 90 percent of all businesses, including the vast majority of small- and medium-sized companies, are owned by families. Many large companies, such as Walmart and the Ford Motor Company, continue to be owned largely by people who are related to the company founder.

Advantages of a Family Business

Entrepreneurs who work for their family businesses enjoy the pride and sense of mission that comes with being part of a family enterprise. They also enjoy the fact that their businesses remain in the family for at least one more generation. Some enjoy working with relatives and knowing that their efforts are benefiting family members.

Disadvantages of a Family Business

Family businesses have several drawbacks. Family members, regardless of their ability, often hold senior management positions. This sometimes means that poor business decisions are made. It also makes it difficult to retain good employees who are not members of the family. Family politics often enter into business decision making. Also, the distinction between business life and private life is blurred in family-owned businesses. As a result, business problems end up affecting family life as well. Entrepreneurs who do join their family business must be prepared to make compromises. Unlike individuals who start or buy their own companies, people who work for their families cannot make all decisions themselves. They may also be unable to set policies and procedures as they like.

STARTING YOUR OWN BUSINESS

For one reason or another, joining a family business or operating a franchise may not be possible for you, or you might not be able to find a business to purchase. This means that to be an entrepreneur you will have to establish a business of your own. You need to consider the many advantages and disadvantages of starting your own business.

Advantages of Starting Your Own Business

Entrepreneurs who start their own business get to make decisions about everything from where to locate the business to how many employees to hire to what prices to charge. They are completely independent and create their own destinies. Many entrepreneurs find great satisfaction in starting their own businesses. Many are attracted to the challenge of creating something entirely new. They also get a feeling of triumph when their business turns a profit.

Disadvantages of Starting Your Own Business

There are many risks to consider when you start your own business. You must estimate demand for your product or service. There is no certainty that customers will purchase what you offer. Entrepreneurs who join family businesses, buy an existing business, or buy into franchises do not have this uncertainty because it is already known that customers will buy the product or service. Entrepreneurs who start their own business must also make decisions that other types of entrepreneurs need not make. These decisions include what product or service to offer, where to locate the business, what equipment to buy, and so forth. What may seem to be good decisions at the time may not always have positive results.

CHOOSE A LEGAL FORM OF BUSINESS

SOLE PROPRIETORSHIP

Once you decide to start your own business, you must decide what type of ownership the business will have. A business that is owned exclusively by one person is a sole proprietorship. Sole proprietorships enable one person to be in control of all business aspects. Sole proprietorships may be very small businesses with just a few employees, or they may be large businesses with hundreds of employees.

Advantages of a Sole Proprietorship

The government exercises very little control over sole proprietorships, so such businesses can be established and run very simply. Accurate tax records and certain employment laws must be met, but these are usually the only forms of government regulation for a sole proprietorship. For this reason, the sole proprietorship is the most common form of ownership in the United States. As a sole proprietor, you get to make all of the business decisions and keep all of the profits the business earns.

Disadvantages of a Sole Proprietorship

It can be difficult to raise money for a sole proprietorship. You often are the only person investing money in the business. You also bear the burden of all of the risks. If a sole proprietorship fails and debts remain, the entrepreneur's personal assets may be taken to pay what is owed.

PARTNERSHIP

A business owned by two or more people is a partnership. Many entrepreneurs prefer to go into business with one or more partners so that they have someone with whom to share decision-making and management responsibilities as well as the risks involved with entrepreneurship.

Advantages of a Partnership

Running a business as a partnership means that you will not have to come up with all of the capital alone. It also means that any losses the business incurs will be shared by all of the partners. Partners may offer different areas of expertise and knowledge, which can strengthen the business. Like sole proprietorships, partnerships face very little government regulation.

Disadvantages of a Partnership

Some entrepreneurs do not like partnerships because they do not want to share responsibilities and profits with other people. They fear being held legally liable for the errors of their partners. Partnerships can also lead to disagreements and can end bitterly.

Partnership Agreement

When two or more entrepreneurs go into business together, they generally sign a partnership agreement. The purpose of the partnership agreement is to set down in writing the rights and responsibilities of each of the owners. A typical partnership agreement identifies the following:

- Name of the business or partnership
- Names of the partners
- Type and value of the investment each partner contributes
- Managerial responsibilities to be handled by each partner
- Accounting methods to be used
- Rights of each partner to review and/or audit accounting documents
- Division of profits and losses among the partners
- Salaries to be withdrawn by the partners
- Duration of the partnership
- Conditions under which the partnership can be dissolved
- Distribution of assets upon dissolution of the partnership
- Procedure for dealing with the death of a partner

CORPORATION

A corporation is a business that has the legal rights of a person but is independent of its owners. A share of stock is a unit of ownership in a corporation. There may be many owners, who are called shareholders or stockholders. The corporation, not the owners, pays taxes, enters into contracts, and may be held liable for negligence.

Jim Munroe set up his company, Munroe Office Supply, as a corporation. He created 100 shares of stock worth $1,000 each. Jim then issued 15 shares to each of three outside investors, which means they gave $45,000 total to be shareholders in his company. Jim kept the remaining 55 shares himself. This means that Jim owns 55% of his company while outside investors own a total of 45% of the company. The individual or group that owns the most shares maintains control of the company.

Every corporation has a board of directors, which is a group of people who meet several times a year to make important decisions affecting the company. The board of directors is responsible for electing the corporation's officers, determining their salaries, and setting the corporation's rules for conducting business. The board of directors also decides how much the corporation should pay in dividends. Dividends are distributions of corporate profits to the shareholders. The company's officers, not the board of directors, are responsible for the day-to-day management of the corporation.

Disadvantages of a Corporation

Setting up a corporation is more complicated than setting up a sole proprietorship or a partnership. To incorporate, you will need the assistance of a lawyer, who will help you file articles of incorporation with the state official responsible for chartering, or registering, corporations. Because of this, establishing a corporation can be costly. Articles of incorporation must fully detail the purpose of the business. If the articles are not well written, the corporation's activities can be limited.

Corporations are subject to much more government regulation than are sole proprietorships or partnerships. Another drawback of incorporation is that income is taxed twice. A corporation pays taxes on its income, and shareholders pay taxes on the dividends they receive from the corporation. This means that the corporation's profits are taxed as corporate income and again as individual income. This is known as double taxation.

Advantages of a Corporation

If the corporate form of ownership is complicated and costly, why do entrepreneurs set up corporations? Liability is the main reason. Liability is the amount owed to others. The shareholders' liability is limited to the amount of money each shareholder invested in the company when he or she purchased stock. The personal assets of shareholders may not be taken to pay the debts of the corporation.

Munroe Office Supply has gone bankrupt, leaving $150,000 in debt. Each shareholder can lose only the amount he or she invested in the corporation, so the outside people who invested $45,000 would lose their investment. Jim would also lose his investment of $55,000. If Jim had set up his business as a sole proprietorship, he would have been liable for $150,000 solely. If the business had been set up as a partnership, each of the partners would have been liable for $150,000.

Another advantage of corporations is that money can be raised by selling stock. Also, lenders are more willing to lend money to corporations than to sole proprietorships or partnerships. Finally, because shareholders do not directly affect the management of a corporation, the main shareholder of the company can change through the buying and selling of stock without disrupting the day-to-day business operations.

S Corporation

A traditional form of corporation is technically referred to as a C Corporation. However, a small corporation can elect to be treated as an S Corporation. An S corporation is a corporation organized under Subchapter S of the Internal Revenue Code. Unlike regular corporations, an S corporation is not taxed as a business. The individual shareholders are taxed on the profits they earn, as they would be in a partnership. However, S corporations must follow the same formalities and recordkeeping procedures as regular corporations. They are also managed by a board of directors and officers. Many companies establish themselves as S corporations because they lose money in their early years. The owners can use any losses suffered from the S corporation to offset other sources of personal income and receive a tax break.

Limited Liability Company

A limited liability company (LLC) is a legal form of business that goes further than an S corporation in providing the benefits of partnership taxation and limited personal liability for all the owners of the business. The LLC is not subject to the rules for an S corporation so it is simpler to operate. Owners of LLCs are known as members – not shareholders. Unlike shareholders, members can participate in the management of the business. The disadvantages are that the type of businesses that can be set up as an LLC may be limited by state law and some states limit the life of an LLC. Since LLCs are traditionally just partnerships with added liability protection, operating an LLC with only one owner (called a Single-Member LLC or SMLLC) can cause some legal and tax issues as well. Every state has different laws regarding LLCs and SMLLCs, so do some research.

1-8 How Economic Decisions Are Made

OBJECTIVES

- ***Compare and contrast different types of economic systems.***
- ***Describe the characteristics of the U.S. economy.***
- ***Explain how scarcity affects economic decisions.***
- ***Explain how business functions are used to satisfy consumers.***

ECONOMIC SYSTEMS

Different economic systems exist throughout the world. However, all economies must answer three basic questions.
1. What goods and services will be produced?
2. How will the goods and services be produced?
3. For whom will the goods and services be produced (in other words, whose needs and wants will be satisfied)?

If all economies struggle with the same basic questions, what is it that makes economies different? The type of economic system will determine how these three economic questions are answered. Economies must choose a way to allocate the goods and services that are available to the people who need or want them. These different allocation processes are what create different economies.

COMMAND ECONOMY

In a command economy, the government determines what, how, and for whom products and services are produced. Because the government is making the decisions, there is very little choice for consumers in what is available. The government may see no reason to have more than one type of the same item. This means individuals may not always be able to obtain exactly what they want. There will be shirts and pants, but there will not be many styles and colors from which to choose.

MARKET ECONOMY

Market economies are about personal choice. In a market economy, individuals and businesses decide what, how, and for whom goods and services are produced. Entrepreneurship thrives in a market economy. Decisions about production and consumption are made by millions of people, each acting alone. Individual choice creates the market, so there are many items available that are very similar. If a product sells, it will remain on the market. If not, the manufacturer will not continue to produce it. Individual choice also exists in how items are produced. A furniture maker will make choices regarding the style, fabric, and durability of products made. In addition, products and services are always available to everyone who has the means to pay for them.

TRADITIONAL ECONOMY

Before complex economic systems developed, simple economies operated according to tradition or custom. In a traditional economy, goods and services are produced the way they have always been produced. The traditional economy is used in countries that are less developed and are not yet participating in the global economy. Most of what is produced is consumed, and what is left over is sold or traded with people who live in nearby communities. Traditional economies lack the formal structure found in more advanced economic systems and usually have limited capital resources available to improve their conditions.

MIXED ECONOMY

When elements of the command and market economies are combined, it is called a mixed economy. A mixed economy often results when a country shifts away from a command economy toward a market economy but still has government involvement in the marketplace. Many countries are making this shift.

- For over 70 years, the Soviet Union operated under a command economic systen1 called communism. Government control resulted in limited choices and a shortage in supply of many consumer goods. The Soviet Union disbanded and became 15 independent states in the early 1990s, resulting in a move toward market economies.
- China operates under a different type of communist government that controls most of the resources and decisions. The economy of China is adopting elements of a market system for a growing number of economic decisions. Entire regions of the country are enjoying a market economy based on greater individual freedom of choice. China is fast becoming a world leader in goods and services produced.

As countries with traditional economies develop, they often adopt mixed economies. The government makes many of the decisions about how the country's resources will be used to develop schools, hospitals, roads, and utilities. As people become educated, they are able to obtain jobs and earn money to purchase more goods and services. Often businesses from other countries will open a business in the developing country and offer jobs and locally produced products to the citizens.

THE U.S. ECONOMIC SYSTEM

What type of economic system do you think the United States has? To answer this question, you must look at who makes most of the decisions about what is produced and consumed. Since individual businesses and consumers make most of these decisions, the U.S. system is best described as a market economy (but not a *pure* market economy, since government plays an important role in regulation).

Capitalism, which is the private ownership of resources by individuals rather than by the government, is another name for the economic system in the United States. Another term often associated with the U.S. economy is free enterprise, due to the freedom of businesses and individuals to make production and consumption decisions. This individual freedom is vital to the success of the U.S. economy.

The U.S. economic system is based on four basic principles: private property, freedom of choice, profit, and competition.

Private Property

As a U.S. citizen, you can own, use, or dispose of things of value. You are free to own anything you want, and you can decide what to do with it as long as you operate within the law.

Freedom of Choice

You can make decisions independently and must accept the consequences of those decisions. Business owners are free to choose where to open a business, what to sell, and how to operate the company. Consumers are free to choose where to shop, what to buy, and how much they want to spend. Only when individual decisions will bring harm to others does the government regulate freedom of choice.

Profit

The difference between the revenues earned by a business and the costs of operating the business is called profit. The opportunity to earn a profit is at the heart of the free -enterprise system. One of the main reasons entrepreneurs invest resources and take risks is to make a profit. No business is guaranteed to make a profit, so entrepreneurs are challenged to work hard, invest wisely, and produce goods and services that consumers are willing to buy.

Competition

The rivalry among businesses to sell their goods and services is called competition. Consumers choose products and services based on the value they think they will receive. Competition forces a business to improve products, keep costs low, provide good customer service, and search for new ideas so that consumers will choose its products or services.

ECONOMIC CHOICES

Individuals and businesses are faced with economic choices every day. Decisions about needs and wants must be made. Economic decision making is the process of choosing which needs and wants, among several, you will satisfy using the resources you have. Two factors commonly enter into economic decision making- scarcity and opportunity cost.

Scarcity

In every economy, there are limited resources to produce goods and services. However, individuals have unlimited needs and wants. This produces the basic economic problem of scarcity. Scarcity occurs when people's needs and wants are unlimited and the resources to produce the goods and services to meet those needs and wants are limited. For example, land is a scarce resource. Land is used for many purposes, such as for growing crops or as a site for a business or house. The same parcel of land cannot be used to meet all of these needs. A decision on how to use it must be made.

Decisions based on scarcity affect everyone. Individuals and families have many wants and needs. They must decide how to spread their income among all these wants and needs. National, state, and city governments collect taxes from their citizens. They must decide how to use the tax collections to provide all the services that citizens expect. In both cases, someone must make difficult choices.

Scarcity forces you to make choices or decisions. Suppose you earn $150 a week. If you decide to purchase a $75 concert ticket and you owe $75 for your monthly car insurance payment, you will not have any money left over to go out for pizza. Because you have only $150, you have limited resources. With limited resources, you cannot afford to buy everything you want. You may have to make a tradeoff by giving up something so that you can have something else.

Opportunity Cost

When trying to satisfy your wants and needs, you most likely will have many alternatives from which to choose. Economic decision making will force you to explore all of your alternatives. When examining all of your alternatives, you should consider the opportunity cost of each one. Opportunity cost is the value of the next-best alternative – the one you pass up. If your grandparents give you $300 for graduation, you have to decide what to do with it. If you decide to save the money for college, the opportunity cost would be the new iPod that you really wanted and could have purchased with the money.

Diane Mayfield has $2,500 in extra cash that she wants to invest in her cake decorating business. Diane could use the money for advertising or she could purchase new equipment. If she decides to use the money for advertising, she will not be able to purchase new equipment. The opportunity cost of advertising will be the value of the new equipment- the next best alternative. Like all entrepreneurs, Diane will have to choose between various investment options.

FUNCTIONS OF BUSINESS

In a market economy, an entrepreneur is free to produce and offer to consumers any legal product or service. Knowledge of business activities will help entrepreneurs satisfy customers and make a profit. These activities or functions of business include the following: production, management, marketing, and finance. Each of these functions is dependent on the others in order for the business to be effective. Products can be produced, but if management is not functioning properly, if adequate financial records are not maintained, or if marketing is not getting the word out to consumers, the products probably will not be sold at a profit.

Production

The primary reason a business exists in a market economy is to provide products or services to consumers and to earn a profit. The production function creates or obtains products or services for sale.

Marketing

All businesses in a market economy need to complete marketing activities in order to make their products and services available to consumers. These activities make up the marketing mix, which includes the following: product, price, place (or distribution), and promotion. The goal is to attract as many customers as possible so that the product succeeds in the marketplace.

Management

It is necessary for all businesses in a market economy to spend a great deal of time developing, implementing, and evaluating plans and activities. Setting goals, determining how goals can be met, and deciding how to respond to the actions of competitors is the role of management. Management also solves problems, oversees the work of employees, and evaluates the activities of the business.

Finance

One of the first responsibilities of finance is determining the amount of capital needed for the business and how the capital will be obtained. The finance function also involves planning and managing the financial records of the business.

1-9 What Affects Price?

OBJECTIVES

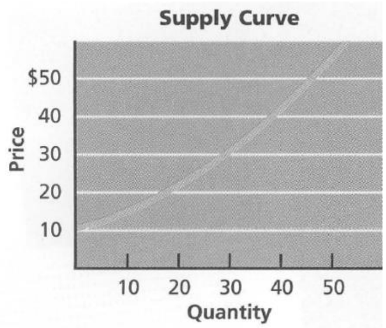
- ***Recognize how supply and demand interact to determine price.***
- ***Describe how costs of doing business affect the price of a good or service.***
- ***Explain the effect of different market structures on price.***

HOW MUCH IS ENOUGH?

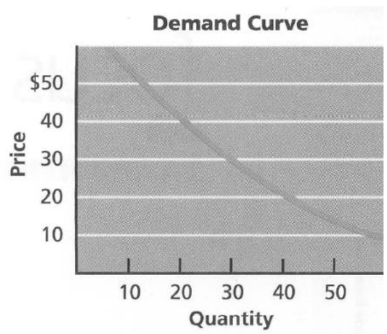
If a market economy is based on personal choice, why does there always seem to be just enough of everything? In a market economy, individual consumers make decisions about what to buy, and businesses make decisions about what to produce. Consumers are motivated to buy goods and services that they need or want. Business owners are driven by the desire to earn profits. These two groups, consumers and producers, together determine the quantities and prices of goods and services produced.

SUPPLY AND DEMAND

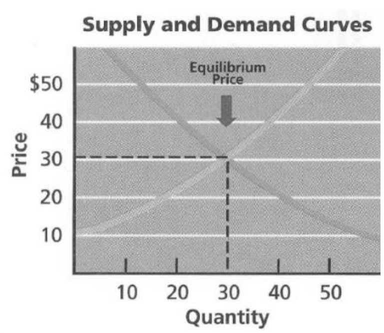
To understand how this works, you need to understand two important forces: supply and demand.



Suppliers are willing to supply more of a product or service at a higher price.



Individuals are willing to consume more of a product or service at a lower price.



The point at which the supply and demand curves intersect indicates the equilibrium price and quantity. The equilibrium price is $30 a unit, and 30 units will be produced.

Supply is the quantity of a good or service a producer is willing to produce at different prices. Imagine that you supply car detailing services. Suppose that at a rate of $40, you are willing to spend eight hours a week providing car detailing services. If your customers are willing to pay just $20 for a car detail, you might decide not to bother detailing cars at all. If, however, the rate for car detailing rose to $60, you would probably increase the number of cars you would detail. You might even try to get some friends to help you detail even more cars.

As the price of car detailing services rises, suppliers are willing to provide more services. The quantity of car detailing services supplied rises as the price for car detailing services increases, as shown on the supply curve graph.

Now consider the demand side of the market economy. Demand is the quantity of a good or service that consumers are willing to buy at a given price. Suppose that you are interested in having your car detailed. At a rate of $40, you figure it is worth having your car detailed once a month. If, however, the rate fell to just $20, you might be willing to have your car detailed twice a month.

As the price of the service or product decreases, consumers are willing to purchase more of the product or service. Demand rises as the price falls, as shown on the demand curve graph.

When the demand for a product is affected by its price, this is referred to as demand elasticity. When a change in price creates a change in demand, you have elastic demand. When a change in price creates very little change in demand, you have inelastic demand. Demand is usually inelastic when:

- There are no acceptable substitutes for a product that consumers need
- The change in price is small in relation to the income of the consumer, so consumers will continue to buy the product if they want it
- The product is a basic need for consumers, rather than just a want

WHEN SUPPLY AND DEMAND MEET

How do the forces of supply and demand work together to determine price in a market economy? The point at which the supply and demand curves meet is known as the equilibrium price and quantity. This is the price at which supply equals demand. Above the equilibrium price, fewer people are interested in buying goods and services because they are priced too high. Below the equilibrium price, consumers are willing to purchase more of the goods or services at the lower prices, but suppliers are not willing to produce enough to meet their demand. Only at the equilibrium price does the amount that consumers want to buy exactly equal the amount producers want to supply.

COSTS OF DOING BUSINESS

To determine how much profit they are earning, entrepreneurs need to know how much it costs to produce their goods or services. To do so, they must consider all the resources that go into producing the good or service to determine a price to charge. Resources may include office space, materials, labor, and equipment. A company that prices its product based only on the cost of materials involved in producing it will lose money and go out of business very quickly.

FIXED AND VARIABLE COSTS

Every business has fixed costs and variable costs. Fixed costs are costs that must be paid regardless of how much of a good or service is produced. Fixed costs are also called sunk costs. Variable costs are costs that go up and down depending on the quantity of the good or service produced.

The Bread and Bagel Shop is a small business owned by Michael Miller. Whether or not Michael makes any sales, he must pay the same monthly rent, the same insurance fees, and the same interest on the loans taken out to finance his business. These are Michael's fixed costs. The store also has variable costs, including the expense of buying flour, sugar, and coffee. These expenses rise directly with the number of items sold. The more bagels, donuts, and cups of coffee the company sells, the more resources it must buy to make more goods. In contrast, when customers purchase fewer loaves of bread, Michael uses less flour and other ingredients.

Understanding the difference between fixed and variable costs is important. A business with many fixed costs is a higher risk than a business with mostly variable costs because fixed costs will be incurred regardless of the level of sales. If sales are lower than expected, the business will have less revenue to pay the bills.

MARGINAL BENEFIT AND MARGINAL COST

Entrepreneurs make business decisions based on the concepts of marginal benefit and marginal cost. Marginal benefit measures the advantages of producing one additional unit of a good or service. Marginal cost measures the disadvantages of producing one additional unit of a good or service.

Michael Miller of The Bread and Bagel Shop wants to increase his sales. Michael is considering keeping the store open two extra hours every day. He estimates that during the last two hours of every day, he will sell an additional 50 baked goods and 20 cups of coffee, bringing in additional daily revenues of $100. This $100 represents the marginal benefit of keeping the store open an extra two hours a day.

To determine if staying open later makes economic sense, Michael needs to calculate the marginal cost of staying open later. He will need to purchase additional ingredients to produce another 50 baked goods and 20 cups of coffee. He will have to pay overtime wages to at least two employees. He will also use more electricity. After adding up these costs, Michael estimates that staying open two extra hours will cost him $125 per day. Because the marginal cost of staying open ($125) exceeds the marginal benefit ($100), Michael decides not to change the store's hours.

ECONOMIES OF SCALE

When a business owner decides to grow the business, he or she needs to consider the economies of scale, which are the cost advantages obtained due to expansion. Businesses can expand their scale of operations in many ways, such as expanding the size of their facility, obtaining specialized machinery, and using a greater specialization of labor. Economies of scale represent an increase in efficiency of production as the number of units of goods produced increases. A business that achieves economies of scale lowers the average cost per unit through increased production because costs can be spread over an increased number of units. Lower costs per unit allow businesses to lower the prices of their product or service, which may attract more customers.

MARKET STRUCTURE AND PRICES

Market structure is determined by the nature and degree of competition among businesses that operate in the same industry. The main criteria used to distinguish between different market structures are the number and size of sellers and buyers in the market, the type of goods and services being traded, and the barriers to entry into the market for sellers. There are four major market structures: perfect competition, monopolistic competition, oligopoly, and monopoly.

PERFECT COMPETITION

A market with perfect competition consists of a very large number of businesses producing nearly identical products and has many buyers. Buyers are well-informed about the price, quality, and availability of products. Because consumers have so many choices of similar products, price is often the deciding factor, making it difficult for a single business to raise prices. This gives consumers more control of the market. Businesses can easily enter or leave this type of market. Examples of industries in perfect competition include gasoline suppliers and producers of agricultural products such as wheat and corn.

MONOPOLISTIC COMPETITION

A market with monopolistic competition has a large number of independent businesses that produce goods and services that are somewhat different. Each business has a very small portion of the market share. This is also called a competitive market. In a competitive market, many suppliers compete for business, and buyers shop around for the best deal they can find. In this kind of market, prices are said to be determined competitively. Products offered are not identical but very similar, so differentiating products is important. Businesses can easily enter or leave a market that has monopolistic competition. Businesses in this market include retail stores and restaurants.

OLIGOPOLY

When a market is dominated by a small number of businesses that gain the majority of total sales revenue, it is called an oligopoly. Businesses in this market sell similar goods and services that are close substitutes, and they have influence over the price charged. With the dominance of a few businesses, it is not easy for new ones to enter the industry. Examples include the automobile and airline industries.

MONOPOLY

Where there is only one provider of a product or service, a monopoly exists. A company that has a monopoly is able to charge whatever price it wants because consumers have nowhere else to go to find a better price. This is the opposite of a competitive market where consumers can simply switch to a lower-priced good or service offered by a competitor. Monopolies usually exist because of barriers that make it difficult for new businesses to enter the market. Examples include local water and electric utility companies.

Chapter Summary

- **Entrepreneurship is the process of running a business of one's own. The owner is called an entrepreneur.**
- **Small businesses contribute more to the U.S. economy than all large businesses combined and contribute to the economic recovery of the country during economic downturns.**
- **Factors that contribute to a new business's success or failure include having adequate capital and being large enough to have employees. The owner's education level and business experience are also important factors.**
- **Successful entrepreneurs tend to be independent, self-confident, goal-oriented, and creative.**
- **Entrepreneurs must have good team-building skills and be able to work well with others.**
- **To determine whether entrepreneurship is right for you, you will need to assess your strengths, weaknesses, interests, and aptitudes.**
- **Ideas for new businesses can come from many different sources, including your hobbies and interests, your past experiences, and a discovery or invention.**
- **You may research business opportunities online and at the library and the Small Business Administration. Other sources of information include trade shows and other entrepreneurs.**
- **Entrepreneurs should set SMART goals, which are specific, measurable, attainable, realistic, and timely. Goals can be**
- **categorized as financial and nonfinancial.**
- **Economics is about making choices and satisfying the needs and wants of consumers. Needs are things you must have to survive. Wants are things you think you must have to be satisfied.**
- **There are generally four types of businesses: manufacturing, wholesaling, retailing, and service. Two other categories of businesses are agricultural and mining and extracting businesses.**
- **Three kinds of economic resources are used by entrepreneurs to produce goods and services-natural resources, human resources, and capital resources.**
- **Entrepreneurs play an important role in the U.S. economy. They supply goods and services, provide capital investment and job creation, and serve as agents for change.**
- **In a command economy, the government determines what, how, and for whom products and services are produced. In a market economy, individuals decide what, how, and for whom products and services are produced. A mixed economy combines elements of the command and market economies. Traditional economies are simple economies operated according to tradition or custom.**
- **The U.S. economic system is based on the principles of private property, freedom of choice, profit, and competition.**
- **Economic choices are necessary because of our unlimited desires and the scarcity of resources available to satisfy them. Every economic decision incurs an opportunity cost.**
- **The functions of business are production, marketing, management, and finance. Each function is dependent on the others.**
- **Supply is the quantity of a good or service a producer is willing to produce at different prices. Demand is the quantity of a good or service that consumers are willing to buy at a given price.**
- **Fixed costs remain the same regardless of how much of a good or service is produced while variable costs go up and down depending on the level of production.**
- **Market structure is determined by the nature and degree of competition among businesses that operate in the same industry. The four major market structures are perfect competition, monopolistic competition, oligopoly, and monopoly.**