Chapter 8 Business Organizations

Taking care of business can mean working by yourself out of your home or managing a company with thousands of employees and offices across the globe. It can mean being the sole owner of a company or one of thousands. It can also mean working for something other than a for-profit business.

Economics Journal

List the four businesses you and your family visit the most often. Are they local businesses or national chains? Describe each one in a few sentences.

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Section 1 Sole Proprietorships

Preview

Objectives

After studying this section you will be able to:

1. **Explain** the characteristics of sole proprietorships.
2. **Analyze** the advantages of a sole proprietorship.
3. **Analyze** the disadvantages of a sole proprietorship.

Section Focus

A business is an economic institution that seeks a profit by allocating resources to satisfy customers. Sole proprietorships are the most common form of business in the United States. They are easy to establish and offer owners both the benefits and drawbacks that come with full control of a business.

Key Terms

business organization
sole proprietorship
business license
zoning law
liability
fringe benefit

Entrepreneurs must make many decisions as they start up new businesses. One of the first decisions they face is what form of business organization best serves their interests. A **business organization** is an establishment formed to carry on commercial enterprise. In other words, a business organization is a company, or firm. Sole proprietorships are the most common forms of business organization.

The Role of Sole Proprietorships

A **sole proprietorship** is a business owned and managed by a single individual. That person earns all of the firm's profits and is responsible for all of the firm's debts. This type of firm is by far the most popular in the United States. According to the Internal Revenue Service, about 75 percent of all businesses are sole proprietorships. Most sole proprietorships are small, however. All together they generate only about 6 percent of all United States sales.

Many types of businesses can flourish as sole proprietorships. Look around your town. Chances are good that your local bakery, your barber shop or hair salon, your bike-repair shop, and the corner store are all sole proprietorships.

Advantages of Sole Proprietorships

While you need to do more than just hang out a sign to start your own business, a sole proprietorship is simple to establish. It also offers the owner numerous advantages.

business organization *an establishment formed to carry on commercial enterprise*

sole proprietorship *a business owned and managed by a single individual*

◀ **Personal pride motivates many sole proprietors.**

It takes a certain type of personality to start up a business.

Entrepreneurs **Describe some times when you exhibited entrepreneurial spirit.**

Figure 8.1 The Entrepreneurial Spirit

Entrepreneurs . . .

- ★ Seek out responsibility
- ★ Are willing to take risks
- ★ Believe in themselves
- ★ Desire to reach their full potentials
- ★ Have high energy levels
- ★ Are upbeat and optimistic
- ★ Look toward the future rather than the past
- ★ Value achievement over money
- ★ Maintain flexibility as they face new challenges
- ★ Are strongly committed to their goals

Ease of Start-Up

Easy start-up is one of the main advantages of the sole proprietorship. With just a small amount of paperwork and legal expense, just about anyone can start a sole proprietorship.

business license *authorization to start a business issued by the local government*

To start a new business, a sole proprietor must meet a small number of government requirements, which can vary from city to city and state to state. Typically, sole proprietors must meet the following minimum requirements:

1. *Authorization* Sole proprietors must obtain a **business license,** which is an authorization from the local government. Certain professionals, such as doctors and day-care providers, may also be required to obtain a special license from the state.
2. *Site permit* If not operating out of the home, a sole proprietor must obtain a certificate of occupancy to use another building for business.
3. *Name* If not using his or her own name as the name of the business, a sole proprietor must register a business name.

This paperwork often takes only a day or two to complete. The most difficult part of starting a new business is coming up with a good idea!

Figure 8.2 Characteristics of Proprietorships

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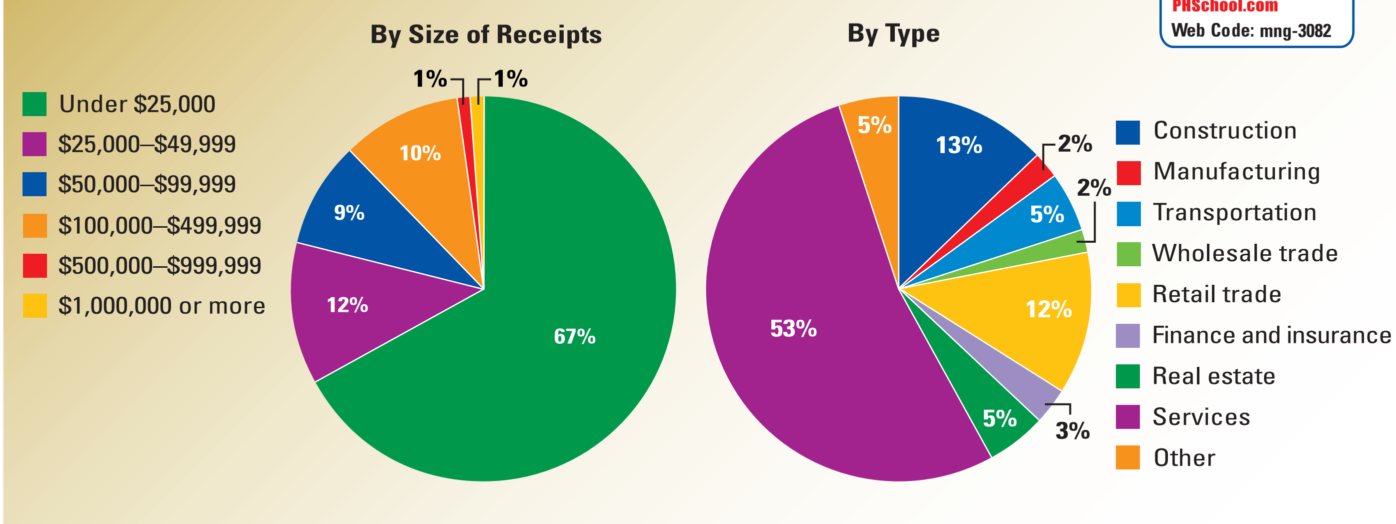

Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States,* 2004–2005

Most sole proprietorships take in relatively small amounts of money, or receipts. Many proprietors run their businesses part-time.

Specialization **What percentage of sole proprietorships is engaged in retail trade? Why might more sole proprietors be engaged in services rather than manufacturing?**

Relatively Few Regulations

A proprietorship is the least-regulated form of business organization. Even the smallest business, however, is subject to some regulation, especially industry-specific regulations. For example, a gourmet soft pretzel stand would be subject to health codes, and a furniture refinishing business would be subject to codes regarding dangerous chemicals.

Sole proprietorships may also be subject to local **zoning laws.** Cities and towns often designate separate areas, or zones, for residential use and for business. Zoning laws may prohibit sole proprietors from operating businesses out of their homes.

Otherwise, these small businesses face few legal requirements. Because they require little legal paperwork, sole proprietorships are usually the least expensive form of ownership to establish.

Sole Receiver of Profit

A major advantage of the sole proprietorship is that the owner gets to keep all profits after paying income taxes. Potential profits motivate many people to start their own businesses. If the business succeeds, the owner does not have to share the success with anyone else.

Full Control

Another advantage of sole proprietorship is that sole proprietors can run their businesses as they wish. This means that they can respond quickly to changes in the marketplace. Such a degree of freedom appeals to entrepreneurs. Fast, flexible decision making allows sole proprietorships to take full advantage of sudden opportunities.

Easy to Discontinue

Finally, if sole proprietors decide to stop operations and do something else for a living, they can do so easily. They must, of course, pay all debts and other obligations like taxes, but they do not have to meet any other legal obligations to stop doing business.

▲ **What are the benefits of running a business from home?**

Disadvantages of Sole Proprietorships

As with everything else, there are trade-offs with sole proprietorships. The independence of a sole proprietorship comes with a high degree of responsibility.

Unlimited Personal Liability

The biggest disadvantage of sole proprietorship is unlimited personal liability. **Liability** is the legally bound obligation to pay debts. Sole proprietors are fully and personally responsible for all their business debts. If the business fails, the owner may have to sell personal property to cover any outstanding obligations.

For example, let's say you took out a loan to buy a ride-on lawn mower as part of your landscaping business. Even if you don't make enough money to stay in business, you must still repay the loan for the lawn mower. Business debts can ruin a sole proprietor's personal finances.

Limited Access to Resources

If your landscaping business takes off and grows quickly, you might need to expand

zoning law *law in a city or town that designates separate areas for residency and for business*

liability *the legally bound obligation to pay debts*

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your business by buying more equipment. But as a sole proprietor, you may have to expand by paying for the equipment out of your own pocket. This is because banks are sometimes unwilling to offer financing in the early days of a business. Many small business owners use all of their available savings and other personal resources to start up their businesses. This makes it difficult or impossible for them to expand quickly.

fringe benefit *payment other than wages or salaries*

Physical capital may not be the only factor resource in short supply. Human capital may be lacking, too. A sole proprietor, no matter how ambitious, may lack some of the skills necessary to run a business successfully. All individuals have strengths and weaknesses. Some aspects of your business may suffer if your skills don't match the needs of the business. For example, you may be great at sales, but not at bookkeeping and accounting. You may love working outdoors landscaping, but hate to call on people to drum up business.

Finally, as a sole proprietor, you may have to turn down work because you simply don't have enough hours in the day or enough workers to keep up with demand. A small business often presents its owner with too many demands, and that can be exhausting both personally and financially.

Lack of Permanence

A sole proprietorship has a limited life. If a sole proprietor dies or closes shop due to retirement, illness, loss of interest in the business, or for any other reason, the business simply ceases to exist.

Sole proprietorships often have trouble finding and keeping good employees. Small businesses generally cannot offer the security and advancement opportunities that many employees look for in a job. In addition, many sole proprietorships are able to offer employees little in the way of fringe benefits. **Fringe benefits** are payments to employees other than wages or salaries, such as paid vacation, retirement pay, and health insurance. Lack of experienced employees can hurt a business. Once again, the flip side of total control is total responsibility: a sole proprietor cannot count on anyone else to maintain the business.

Section 1 Assessment

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Key Terms and Main Ideas

1. What is a **business organization?**
2. What is a **sole proprietorship?**
3. What role do **business licenses** and **zoning laws** play in sole proprietorships?
4. What kinds of **liabilities** are sole proprietors subject to?
5. Why do you think many sole proprietorships are able to offer few **fringe benefits** to workers?

Applying Economic Concepts

6. ***Using the Databank*** Examine the graph "Fastest-Growing Occupations" on page 537. Which of these occupations do you think could operate successfully as sole proprietorships? Explain your reasoning.
7. ***Try This*** Refer to Figure 8.1, "The Entrepreneurial Spirit," on page 186. How many of these traits do you have? Would you like to start your own business someday? Why or why not?

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ECONOMIC

Profile

Economist

Entrepreneur

Jerry Yang (b. 1968)

When 10-year-old Jerry Yang arrived in California from Taiwan with his brother, mother, and grandmother, the only English word he knew was shoe. *Some 15 years later he had mastered the language well enough to come up with "Yet Another Hierarchical Officious Oracle!" as the name for an on-line directory of Internet addresses that he and his friend David Filo had developed. The initials gave the directory the name Yang really wanted: Yahoo!*

The Birth of Yahoo!

Yang and Filo were graduate students in engineering and shared an office at Stanford University in 1993. At the time, the World Wide Web was in its infancy, and the two office mates began to spend time exploring the new Web. When they could not remember the addresses of interesting Web sites they had visited, they decided to make a reference list. In early 1994, they put their list on-line for friends to use. As the list got longer, Filo and Yang divided it into categories, and the Internet directory Yahoo! was born.

A Hobby Becomes a Business

By the end of 1994, word of a great, free catalog of Web pages had spread well beyond the university. Yang and Filo's site was getting a million visits a day, and Stanford began to rethink letting the university's equipment be tied up in this way. Yahoo! produced no revenue to cover expenses, so Yang and Filo began to consider how they might turn their hobby into a self-sustaining company. With the help of a business student friend, they developed a business plan and began to look for financing.

In April 1995, an investment firm put up $1 million to get Yahoo! Corporation started. America Online (AOL), the world's largest Internet service provider, asked Yahoo! to be its search engine. The prospect of visits from millions of AOL subscribers convinced Filo and Yang to sell advertising space on the Yahoo! site.

The Yahoo! Explosion

In 1996, Yang and Filo offered Yahoo! stock to the public for the first time. The money raised allowed the company to greatly expand its services. Although going public eventually reduced their ownership to 25 percent, the founders still participated in the company. Yang remained involved in business operations and Filo in technical development. Yahoo! survived the dot-com crash on the strength of its brand and advertising revenues. By 2003, Yahoo! had become a $20 billion business. Except for the fact that both were now multimillionaires, little had changed since 1994 for Yang and Filo. Yahoo!'s success "hasn't changed my life at all," reports Yang, "except that I think more about taxes."

CHECK FOR UNDERSTANDING

1. **Source Reading** Explain why Yahoo!'s agreement with AOL assured that Yahoo! would be a success.

2. **Critical Thinking** Why are Yang and Filo much wealthier today than they were when they owned 100 percent of the company?

3. **Learn More** Use the Internet and other sources to learn more about Yahoo!'s legal status as a business organization. Has the company's business organization changed over time?

Section 2 Partnerships

Preview

Objectives

After studying this section you will be able to:

1. **Compare and contrast** the different types of partnerships.
2. **Analyze** the advantages of partnerships.
3. **Analyze** the disadvantages of partnerships.

Section Focus

Partnerships let individuals pool their resources and share responsibility for the forming and running of a business.

Key Terms

partnership
general partnership
limited partnership
limited liability partnership (LLP)
articles of partnership
Uniform Partnership Act (UPA)
assets

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partnership *a business organization owned by two or more persons who agree on a specific division of responsibilities and profits*

general partnership *partnership in which partners share equally in both responsibility and liability*

limited partnership *partnership in which only one partner is required to be a general partner*

limited liability partnership (LLP) *partnership in which all partners are limited partners*

A **partnership** is a business organization owned by two or more persons who agree on a specific division of responsibilities and profits. In the United States, partnerships account for about 7 percent of all businesses. They generate about 5 percent of all sales and about 10 percent of all income.

Types of Partnerships

Partnerships fall into three categories: general partnerships, limited partnerships, and limited liability partnerships. Each divides responsibility and liability differently.

Sometimes three heads are better than one. ▶

General Partnership

The most common type of partnership is the **general partnership.** Partners in a general partnership share equally in both responsibility and liability. Many of the same kinds of businesses that operate as sole proprietorships could operate as general partnerships. Doctors, lawyers, accountants, and other professionals often form partnerships with colleagues. Small retail stores, farms, construction companies, and family businesses often form partnerships as well.

Limited Partnership

In a **limited partnership,** only one partner is required to be a general partner. That is, only one partner has unlimited personal liability for the firm's actions. The remaining partner or partners contribute only money. They do not actively manage the business. Limited partners can lose only the amount of their initial investment. A limited partnership must have at least one general partner, but may have any number of limited partners. The main advantage of being a general partner is in having control of the business. The main drawback, of course, is the extent of liability.

Limited Liability Partnerships

The **limited liability partnership (LLP)** is a newer type of partnership recognized by

Figure 8.3 **Characteristics of Partnerships**

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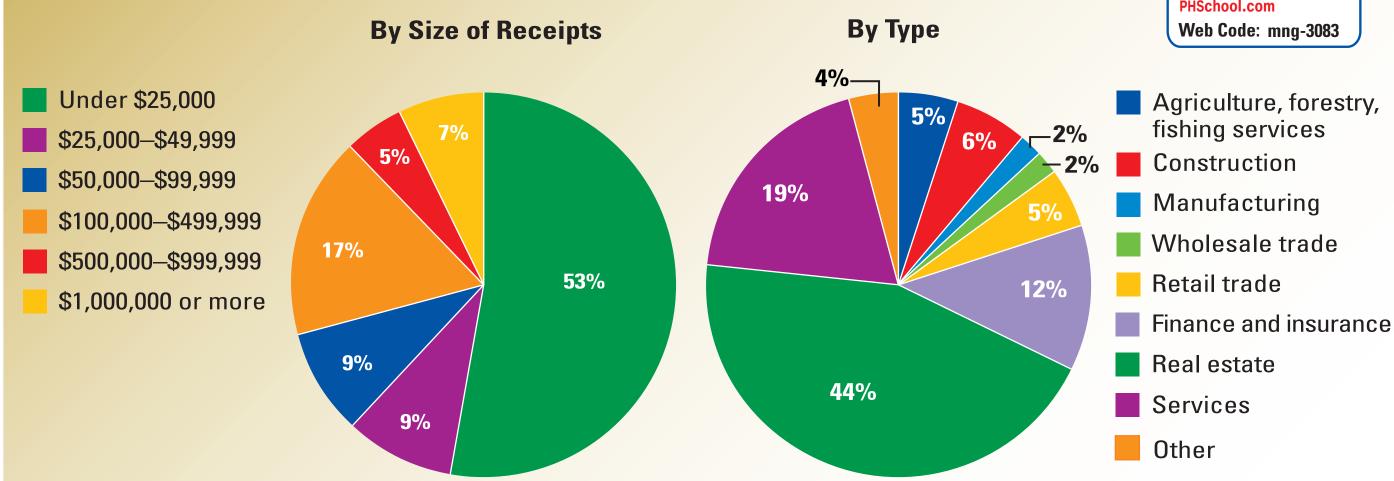

Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States,* 2004–2005

BUILDING KEY CONCEPTS

Partnerships can range in size from a pair of house painters to an accounting firm with thousands of partners.

Specialization **Using the information in these graphs, describe partnerships in terms of industry and income.**

many states. In this type of partnership, all partners are limited partners. An LLP functions like a general partnership, except that all partners are limited from personal liability in certain situations, such as another partner's mistakes. Not all types of businesses are allowed to register as limited liability partnerships. Most states allow professionals such as attorneys, physicians, dentists, and accountants to register as LLPs.

Advantages of Partnerships

Partnerships are easy to establish and are subject to few government regulations. They provide entrepreneurs with a number of advantages.

Ease of Start-Up

Like proprietorships, partnerships are easy and inexpensive to establish. The law does not require a written partnership agreement. Most small business experts, however, advise partners to work with an attorney to develop **articles of partnership,** or a partnership agreement. This legal document spells out each partner's rights and responsibilities. It outlines how partners will share profits or losses. Partnership agreements may also address other details, such as the ways new partners can join the firm, duration of the partnership, and tax responsibilities.

If partners do not establish their own articles of partnership, they will fall under the rules of the **Uniform Partnership Act (UPA).** The Uniform Partnership Act is a uniform state law adopted by most states to establish rules for partnerships. The UPA requires common ownership interests, profit and loss sharing, and shared management responsibilities.

Like sole proprietorships, partnerships are subject to little government regulation. The government does not dictate how partnerships conduct business. Partners can distribute profits as they wish, as long as they abide by the partnership agreement or by the UPA.

articles of partnership *a partnership agreement*

Uniform Partnership Act (UPA) *act ordering common ownership interests, profit and loss sharing, and shared management responsibilities in a partnership*

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Shared Decision Making and Specialization

In a sole proprietorship, the individual owner has the sole burden of making all the business decisions. In a partnership, the responsibility for the business may be shared. A sole proprietorship requires the owner to wear many hats, some of which might not fit very well. In a successful partnership, however, each partner brings different strengths and skills to the business.

Larger Pool of Capital

Each partner's **assets,** or money and other valuables, improve the firm's ability to borrow funds for operations or expansion. Partnership agreements may allow firms to add limited partners to raise funds.

Partnerships offer more advantages to employees, enabling them to attract and keep talented employees more easily than proprietorships can. Graduates from top accounting schools, for example, often seek jobs with large and prestigious accounting LLPs, hoping to become partners themselves someday. Similarly, many law school graduates seek out successful partnerships for employment.

assets *money and other valuables belonging to an individual or business*

Taxation

Partnerships, like sole proprietorships, are not subject to any special taxes. Partners pay taxes on their share of the income that the partnership generates. The business itself, however, does not have to pay taxes.

Disadvantages of Partnerships

Partnerships also present some disadvantages. Many of the disadvantages of sole proprietorships are present in partnerships. Limited liability partnerships have fewer disadvantages than partnerships with general partners. All partnerships, however, have the potential for conflict.

Unlimited Liability

Unless the partnership is an LLP, at least one partner has unlimited liability. As in a sole proprietorship, any general partner could lose everything, including personal property, in paying the firm's debts. Limited partners do not face the same threat. They can lose only their investment.

In a partnership, each general partner is bound by the acts of all other general partners. If one partner's actions cause the firm losses, then all of the general partners suffer. If one doctor in a partnership is

Like sole proprietors, partners must maintain their entrepreneurial spirit to stay in business. ▶

▲ **These partners must find positive ways to deal with conflict if they want to keep their business running smoothly.**

sued for malpractice, all of the doctors in the partnership stand to lose. General partners do not enjoy absolute control over the firm's actions like sole proprietors do. The risk from other people's actions means that people must choose their business partners carefully.

Potential for Conflict

As in any close relationship, partnerships have the potential for conflict. Partnership agreements address technical aspects of the business, such as profit and loss. Many important considerations exist outside these legal guidelines, however. Partners need to ensure that they agree about work habits, goals, management styles, ethics, and general business philosophies. Still, friction between partners often arises and can be difficult to resolve. Many partnerships dissolve because of interpersonal conflicts. Partners must learn to communicate openly and find ways to resolve conflicts.

Section 2 Assessment

Progress Monitoring *Online*
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Key Terms and Main Ideas

1. Explain the characteristics of **partnerships.**
2. How do **general partnerships, limited partnerships,** and **limited liability partnerships** differ?
3. What issues are addressed in **articles of partnership?**
4. What is the purpose of the **Uniform Partnership Act?**

Applying Economic Concepts

5. ***Critical Thinking*** Why might accountants and physicians find limited liability partnerships attractive?
6. ***Critical Thinking*** Do you think the advantages of partnerships outweigh the disadvantages? Why or why not?
7. ***Problem Solving*** You and your general partners are operating under the Uniform Partnership Act, not your own articles of partnership. Now you cannot agree who should be responsible for which duties. How will you resolve your conflict?
8. ***Try This*** With a partner or two, draw up articles of partnership for a fictional business. Decide which type of partnership best suits your business and your personal preferences and skills.

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Skills for LIFE

Using the Internet for Research

The Internet is a comprehensive network of computers that links businesses, universities, and individuals around the world. The World Wide Web is one part of the Internet. Because the Internet has no central organization, finding a Web page with the information you need can be difficult. Search engines, databases that track thousands of Web pages by subject, can help you focus your search.

In addition to advertising and product information, many corporations use their Internet sites to post corporate ethics statements like the one below. An ethics statement typically describes how the company approaches the law, the community in which it works, and its employees. Use the steps below to locate a corporate ethics statement on the Web.

1. **Prepare your search.** American companies can face ethical dilemmas over issues like pollution, safety, and working conditions. (**a**) Identify two companies that you think might face ethical issues. (**b**) How could you use the Internet to find these companies?

ETHICS STATEMENT OF ALPINE INVESTMENTS, INC.

Alpine Investments, Inc., and each of its employees will:

- Individually and collectively maintain a high level of ethical conduct with clients, coworkers, members of allied professions, and the public.
- Practice a method of financial planning founded on a legal and practical basis, not voluntarily associating with anyone who violates this principle.
- Seek advice in doubtful or difficult cases, and whenever it appears that the services of members of other professions would provide more complete and better quality or degree of advice.
- Not reveal the private information we may observe in any client's affairs, unless required to do so by law.
- Obey all laws and uphold the dignity and honor of the profession and accept the profession's self-imposed rules.
- Oppose, without hesitation, illegal or unethical conduct of fellow members of our profession.

2. **Refine your search.** Many search engines offer an advanced search option that allows you to refine your search. (**a**) Which words other than "ethics," "statement," and the company name might help you find the documents you are looking for? (**b**) Based on your first set of results, what word could you *exclude* from your search to eliminate inappropriate listings?

3. **Analyze the document.** Answer the following questions using the ethics statement at left. (**a**) List three significant phrases that the company uses in its ethics statement. (**b**) Do you find the company's statement convincing? Why or why not? (**c**) Which words or phrases are not convincing?

Additional Practice

Use the Internet to find an ethics statement for a company that has recently been in the news for a controversial decision or action.

Section 3

Corporations, Mergers, and Multinationals

Preview

Objectives

After studying this section you will be able to:

1. **Explain** the characteristics of corporations.
2. **Analyze** the advantages of incorporation.
3. **Analyze** the disadvantages of incorporation.
4. **Compare and contrast** corporate combinations.
5. **Describe** the role of multinational corporations.

Section Focus

Corporations are complex business organizations that can be combined to form even larger businesses. Some corporate enterprises span the globe.

Key Terms

corporation
stock
closely held corporation
publicly held corporation
bond
certificate of incorporation
dividend
horizontal merger
vertical merger
conglomerate
multinational corporation (MNC)

Businesses often rely on investment to expand operations. One way for a business to increase investment is to form a corporation. A corporation can grow even larger by combining with other corporations. Some corporations are so large that they do business all over the world.

Corporations

The most complex form of business organization is the corporation. A **corporation** is a legal entity, or being, owned by individual stockholders, each of whom faces limited liability for the firm's debts. Stockholders own **stock**, a certificate of ownership in a corporation. In other words, if you own stock in a corporation, you are a part-owner of that corporation. If a corporation issues 1,000 shares of stock, and you purchase 1 share, you own 1/1000th of the company.

Corporations differ from sole proprietorships, which have no identity beyond that of the owners. A corporation is defined as an "entity" because it has a legal identity separate from those of its owners. Legally, it is regarded much like an individual. A

corporation *a legal entity owned by individual stockholders*

stock *a certificate of ownership in a corporation*

Many corporations make their headquarters in large cities. ▼

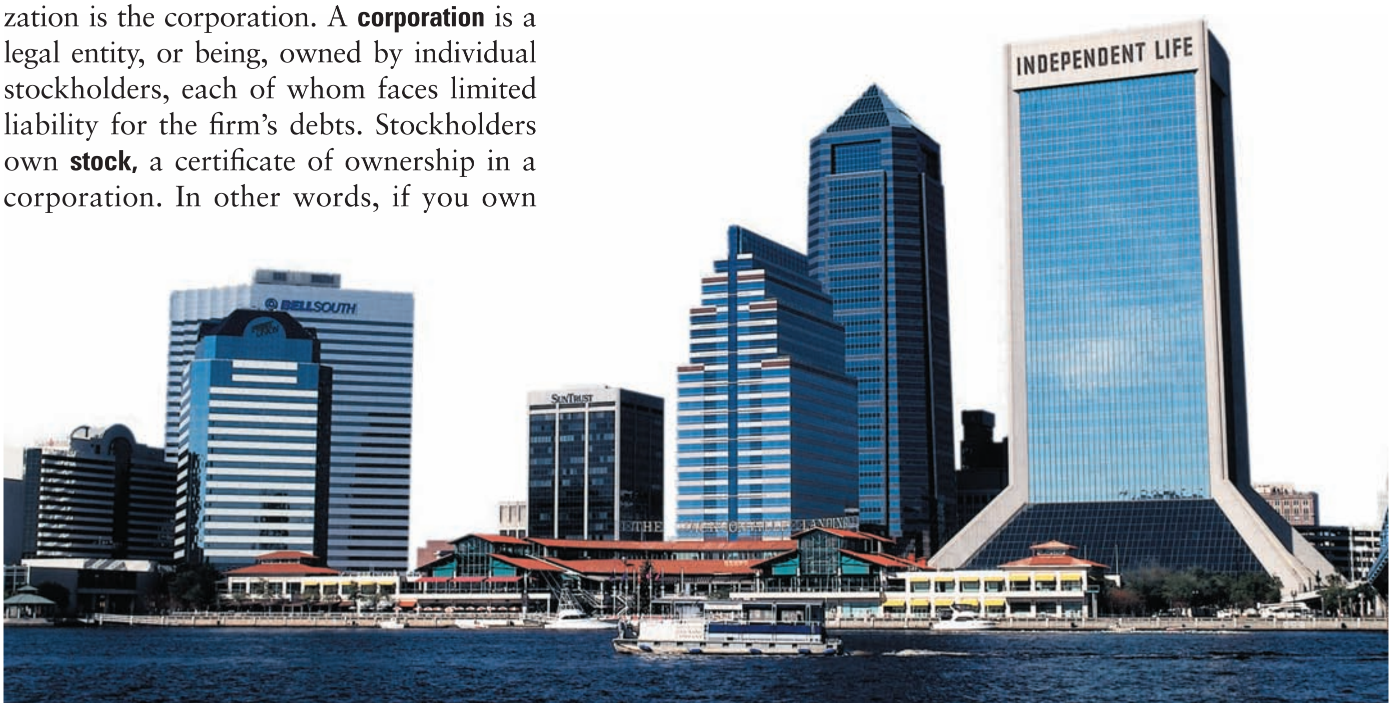

Figure 8.4 Characteristics of Corporations

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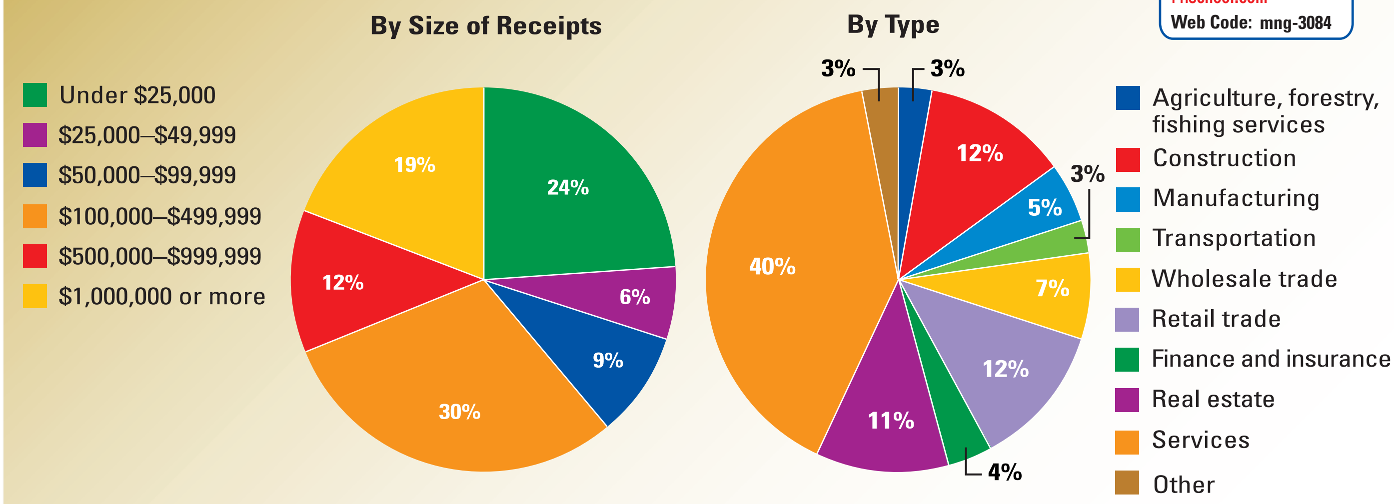


Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States,* 2004–2005

BUILDING KEY CONCEPTS

Notice that over 60 percent of corporations are engaged in services, manufacturing, wholesale trade, and retail trade.
Incentives What incentives do businesses in these particular industries have to form corporations?

closely held corporation *corporation that issues stock to only a few people, often family members*

publicly held corporation *corporation that sells stock on the open market*

corporation pays taxes, may engage in business, make contracts, sue other parties, and get sued by others.

In the United States, corporations account for about 20 percent of all businesses, yet sell about 90 percent of all products sold in the nation. They generate about 70 percent of the net income earned in the nation. Because of the advantages of corporations, most large business firms do incorporate. Supermarkets, high-tech companies, and machinery manufacturers are just some of the types of firms that usually form corporations. Corporations' profits are about ten percent of their income.

Types of Corporations

Some corporations issue stock to only a few people, often family members. These stockholders rarely trade their stock, but pass it on within families. Such corporations are called **closely held corporations.** They are also known as privately held corporations.

A **publicly held corporation,** on the other hand, has many shareholders who can buy or sell stock on the open market. Stocks are bought and sold at financial markets called stock exchanges, such as the New York Stock Exchange. You will read about these financial markets in Chapter 11.

Corporate Structure

While the exact organization varies from firm to firm, all corporations have the same basic structure. Corporation owners—the stockholders—elect a board of directors. The board of directors makes all the major decisions of the corporation. It appoints corporate officers, who run the corporation and oversee production. Corporate officers, in turn, hire managers and employees, who work in various departments like finance, sales, research, marketing, and production.

Advantages of Incorporation

Incorporation, or forming a corporation, offers advantages to both the individual owners, or stockholders, and to the corporation itself. These include

- limited liability for owners
- transferable ownership
- ability to attract capital
- long life

Advantages for Stockholders

The primary reason that entrepreneurs choose to incorporate, or form a corporation, is to gain the benefit of limited liability. Individual investors do not carry responsibility for the corporation's actions. They can lose only the amount of money they have invested in the business.

Corporations usually also provide stockholders with more flexibility than other ownership forms. Shares of stock are transferable, which means that stockholders can sell their stocks to others and get money in return.

Advantages for the Corporation

The corporate structure also presents advantages for the firm itself. Corporations have more potential for growth than other business forms. By selling shares on the stock market, corporations can raise money to purchase capital. A corporation can offer as many shares of stock as its corporate charter allows. As long as investors have confidence in the firm's success, companies should be able to sell stock fairly easily.

Corporations can also raise money by borrowing it. They do this by selling bonds. A **bond** is a formal contract to repay borrowed money with interest at fixed intervals.

Because ownership is separate from the running of the firm, corporation owners—that is, stockholders—do not need any special managerial skills. Instead, the corporation can hire various experts—the best financial analysts, the best engineers, and so forth—to create and market the best services or goods possible.

Corporations also have the advantage of long life. Unlike a sole proprietorship, the company does not end with the death of an owner. Because stock is transferable, that is, it can be bought and sold, corporations are able to exist longer than simple proprietorships. Unless it has stated in advance a specific termination date, the corporation can continue doing business indefinitely.

Disadvantages of Incorporation

Corporations are not without their disadvantages. These include

- expense and difficulty of start-up
- double taxation
- potential loss of control by the founders
- more legal requirements and regulations

Difficulty and Expense of Start-Up

Corporate charters can be difficult, expensive, and time consuming to establish. Though most states allow people to form corporations without legal help, few experts would recommend this cheaper shortcut. Applications are complex and confusing.

Firms that wish to incorporate must first file for a state license known as a **certificate of incorporation,** or corporate charter. The application includes crucial information such as

- the corporate name
- statement of purpose
- length of time that the business will run (usually "for perpetuity," or without limit)
- founders' names and addresses
- headquarters' business address
- method of fund-raising
- the rules for the corporation's management

Once state officials review and approve the application, they grant a corporate charter. Then the corporation may organize itself to produce and sell a good or service.

Double Taxation

The law considers corporations legal entities separate from their owners. Corporations, therefore, must pay taxes on their income.

bond *a formal contract to repay borrowed money with interest at fixed intervals*

certificate of incorporation *license to form a corporation issued by state government*

dividend *the portion of corporate profits paid out to stockholders*

Profit is a form of income. When stockholders receive income from the corporation in the form of **dividends**—the portion of corporate profits paid out to stockholders—the stockholders must pay personal income tax on those dividends. This double taxation keeps many firms from incorporating.

When stockholders sell their shares, they must pay a special tax, called a capital gains tax, if they have made a profit. In 2003, Congress reduced double taxation by lowering the dividend and capital gains tax rates to 15 percent.

Loss of Control

Unlike the owner of a sole proprietorship, the original owners of a corporation often lose control of the company. Managers and boards of directors, not owners, manage corporations. These professional managers do not always act in the owners' best interests. They might be more interested in protecting their own jobs or salaries today than in making difficult decisions that would benefit the firm tomorrow.

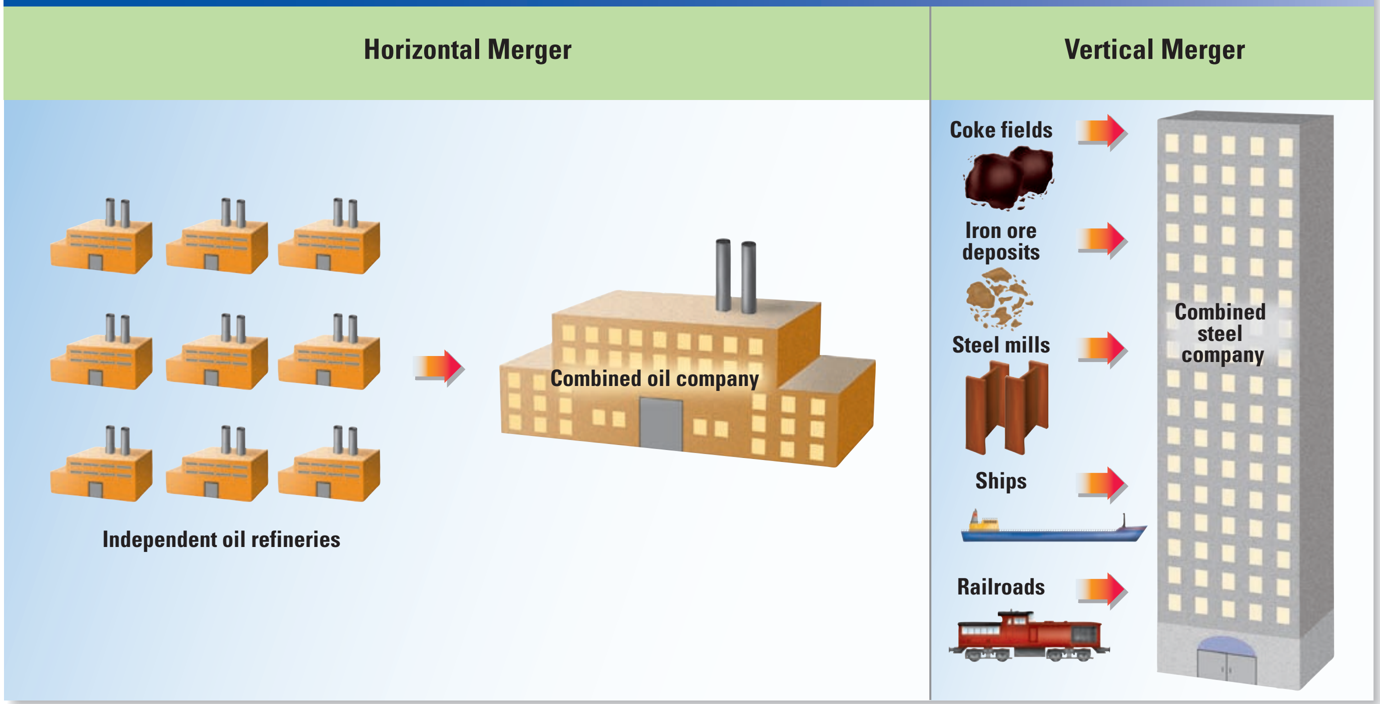
More Regulation

Corporations also face more regulations than other kinds of business organizations. Corporations must hold annual meetings for shareholders and keep careful records of all business transactions. Publicly held corporations are required to file quarterly and annual reports to the Securities and Exchange Commission (SEC). The SEC is a federal agency that regulates the stock market.

Corporate Combinations

As a corporation continues to grow, managers and owners may decide it makes

Figure 8.5 **Horizontal Merger and Vertical Merger**



BUILDING KEY CONCEPTS

Beginning in the 1880s, John D. Rockefeller's Standard Oil Company combined horizontally (left) with 40 other oil refineries. The power gained by Standard Oil and similar monopolies prompted passage of the Sherman Antitrust Act in 1890. In 1899, Andrew Carnegie established the Carnegie Steel Company. He used the vertical merger (right) to purchase ore mines, furnaces and mills, and even the shipping and railroad lines needed to move his products to market. Within a short time, Carnegie controlled the steel industry. Most vertical mergers, however, do not result in monopolies. **Competition** **Explain the difference between horizontal and vertical mergers.**

sense to merge, or combine, the firm with another company or companies. The three kinds of mergers are horizontal mergers, vertical mergers, and conglomerates.

Each of these corporate combinations can lead to larger, more efficient firms. Often, larger firms can produce and sell their products at lower prices. However, their size can also give some of these combinations more monopoly power, as discussed in Chapter 7.

Horizontal mergers

Horizontal mergers join two or more firms competing in the same market with the same good or service. For example, in late 1998, two giant automakers, Chrysler Corporation and Daimler-Benz, merged to form DaimlerChrysler.

Two firms might choose to merge if the newly resulting firm would result in economies of scale or would otherwise improve efficiency. At the time of the merger, Chrysler Corporation and Daimler-Benz predicted that their merger would reduce costs and boost revenues as much as $3 billion dollars annually.

As you read in Chapter 7, the federal government watches horizontal mergers carefully. The resulting single firm might gain monopoly power in its market.

Vertical Mergers

Vertical mergers join two or more firms involved in different stages of producing the same good or service. A vertical merger can allow a firm to operate more efficiently. A vertically combined firm can control all phases of production, rather than rely on the goods or services of outside suppliers. Sometimes firms combine vertically out of fear that they may otherwise lose crucial supplies. To ensure production, these firms simply buy their suppliers.

Antitrust regulators become concerned when many firms in the same industry merge vertically if that merger drives supplying firms out of business. Most vertical mergers do not substantially lessen competition, however, so they are usually allowed.

Figure 8.6 A Conglomerate

Conglomerates combine diverse businesses.
Competition Why don't conglomerates generally decrease competition?

Conglomerates

Sometimes firms buy other companies that produce totally unrelated goods or services. These combinations, called **conglomerates,** have more than three businesses that make unrelated products. In a conglomerate, no one business earns the majority of the firm's profits. The government usually allows this kind of merger, because it does not result in decreased competition.

Multinational Corporations

The world's largest corporations produce and sell their goods and services throughout the world. They are called **multinational corporations (MNCs).** MNCs are corporations that operate in more than one country at a time. They usually have headquarters in one country and branches in other countries. Multinationals, which are sometimes called transnational corporations, must obey laws and pay taxes in each country in which they operate. In the

horizontal merger *the combination of two or more firms competing in the same market with the same good or service*

vertical merger *the combination of two or more firms involved in different stages of producing the same good or service*

conglomerate *business combination merging more than three businesses that make unrelated products*

multinational corporation (MNC) *large corporation that produces and sells its goods and services throughout the world*

▲ **Multinational corporations make their presence felt throughout the world.**

early 2000s, an estimated 63,000 multinational firms operated about 690,000 foreign branches. They accounted for more than $3 trillion of worldwide assets. Many multinational corporations have operating budgets much bigger than most governments' budgets.

Corporations in the United States and Great Britain operated the world's largest multinationals in the 1970s and early 1980s. The picture today shows many different home countries for these giants, including Japan, South Korea, the Netherlands, and Italy.

Advantages of Multinationals

Multinationals benefit consumers and workers worldwide by providing jobs and products around the world. They also spread new technologies and production methods across the globe. Often the jobs they provide help poorer nations gain better living standards for their people.

Disadvantages of Multinationals

On the downside, many people feel that multinational firms unduly influence the culture and politics in the countries in which they operate. While some people feel that MNCs provide much needed jobs, critics are concerned about the low wages and poor working conditions provided by MNCs in some poorer countries. Whatever the advantages and disadvantages, trends suggest that MNCs will become increasingly visible and important in the world economy in the years ahead.

Section 3 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-3087

Key Terms and Main Ideas

1. How does a **corporation** differ from a sole proprietorship or partnership?
2. What is the difference between a **closely held corporation** and a **publicly held corporation?**
3. What information is required in a **certificate of incorporation?**
4. What is **stock?**
5. Why must stockholders pay taxes on **dividends?**
6. What is a merger? How do **horizontal mergers, vertical mergers,** and **conglomerates** differ?
7. Why are some corporations called **multinational corporations?**

Applying Economic Concepts

8. ***Critical Thinking*** Suppose you are deciding whether to incorporate your house-cleaning business. Analyze the consequences of this economic decision.
9. ***Try This*** Identify several sole proprietorships and partnerships in your neighborhood or town. Which of these businesses might benefit from incorporation? Explain your reasoning.
10. ***Critical Thinking*** How might a corporation benefit by being multinational?
11. ***Problem Solving*** You want to incorporate your family business. Will you form a closely held corporation or a publicly held corporation? Explain your reasoning.

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Section 4 Other Organizations

Preview

Objectives

After studying this section you will be able to:

1. **Understand** how a business franchise works.
2. **Identify** the different types of cooperative organizations.
3. **Understand** the purpose of nonprofit organizations, including professional and business organizations.

Section Focus

Some organizations exist to aid business owners, consumers, producers, industries, workers, or society at large. Many operate without the aim of earning a profit.

Key Terms

business franchise
royalty
cooperative
consumer cooperative
service cooperative
producer cooperative
nonprofit organization
professional organization
business association
trade association

Why would a person with dreams of running her own business turn to a multinational company for help? Why would a customer pay a fee for the privilege of shopping at a certain store? Why would an organization have no intention of earning a profit at all?

There are sound answers for all of these questions. As you read this section, you will discover many kinds of organizations that serve many kinds of interests. You are probably already familiar with a number of them.

Business Franchises

In Chapter 7, you learned about franchises issued by government authorities. These franchises give only one firm the right to sell its goods within a limited market, such as within a national park. In business, too, a franchise signals exclusive rights. A **business franchise** is a semi-independent business that pays fees to a parent company. In return, the business is granted the exclusive right to sell a certain product or service in a given area.

Parent companies are called *franchisers*. The franchiser develops the products and business systems. They then work with the local franchise owners to help them produce and sell their products.

The image that leaps to mind when discussing franchises is the fast-food restaurant. However, franchises offer a wide array of goods and services, from diamonds to day-care centers.

business franchise *a semi-independent business that pays fees to a parent company in return for the exclusive right to sell a certain product or service in a given area*

◀ **Competing restaurant franchises often cluster together along highways.**

FAST FACT

Just about any type of business can be franchised. In 1988, one California entrepreneur started a mobile autopsy business. His company has been so successful that it now offers ***business franchises*** *in the United States and abroad.*

royalty *share of earnings given as payment*

cooperative *a business organization owned and operated by a group of individuals for their mutual benefit*

Franchising has become popular in recent years. This is because small franchise businesses allow owners a degree of control. At the same time, the owners benefit from the support of the parent company. As with any other form of business organization, franchises offer both advantages and disadvantages.

Advantages of Franchises

For a small business owner, a franchise can provide advantages a completely independent business cannot. A franchise comes with a built-in reputation. Consumers may already be familiar with the product and brand of the franchise. Other benefits include

1. *Management training and support* Franchisers help inexperienced owners gain the experience they need to succeed.
2. *Standardized quality* Most parent companies require franchise owners to follow certain rules and processes to guarantee product quality.
3. *National advertising programs* Parent companies pay for far-reaching advertising campaigns to establish their brand names.
4. *Financial assistance* Some franchisers provide financing to help franchise owners start their businesses.
5. *Centralized buying power* Franchisers buy materials in bulk for all of their franchise locations. They pass on the savings to their franchise owners.

▲ **What advantages do co-ops offer consumers?**

Disadvantages of Franchises

The biggest disadvantage of a franchise is that the franchise owner must sacrifice some freedom in return for the parent company's guidance. Other disadvantages include

1. *High franchising fees and royalties* Franchisers often charge high fees for the right to use the company name. They also charge franchise owners a share of the earnings, or **royalties.**
2. *Strict operating standards* Franchise owners must follow all of the rules laid out in the franchising agreement for such matters as hours of operation, employee dress codes, and operating procedures. Otherwise, an owner may lose the franchise.
3. *Purchasing restrictions* Franchise owners must often buy their supplies from the parent company or from approved suppliers.
4. *Limited product line* Franchise agreements allow stores to offer only approved products.

Cooperative Organizations

A **cooperative** is a business organization owned and operated by a group of individuals for their shared benefit. In other words, working together, the individuals can provide themselves with certain advantages. Cooperatives, or co-ops, fall into three main categories: consumer, or purchasing cooperatives; service cooperatives; and producer cooperatives.

Consumer Cooperatives

Retail outlets owned and operated by consumers are called **consumer cooperatives,** or purchasing cooperatives. Consumer cooperatives sell merchandise to their members at reduced prices. By making large purchases, consumer cooperatives can obtain goods at a lower cost. They then pass the savings on to members. Examples of consumer cooperatives include discount price clubs, compact disc or book clubs, some health food stores, and housing cooperatives. Some co-ops require members to work a small number of hours per year to maintain their memberships. Others require membership fees instead. For example, your local health food store may require you to work 20 hours per month in order to maintain your membership. Giant discount price clubs, on the other hand, require annual membership fees.

Service Cooperatives

Cooperatives that provide a service, rather than goods, are called **service cooperatives.** Some service co-ops offer discounted insurance, banking services, health care, legal help, or baby-sitting services. Credit unions, or financial cooperatives, lend money to their members at reduced rates.

Producer Cooperatives

Producer cooperatives are agricultural marketing cooperatives that help members sell their products. These co-ops allow members to focus their attention on growing their crops or raising their livestock. The co-ops, meanwhile, market these goods for the highest prices possible.

Nonprofit Organizations

Some institutions function much like business organizations, but do not operate for the purpose of generating profit. These **nonprofit organizations** are usually in the business of benefiting society. Nonprofit organizations include museums, public schools, the American Red Cross, hospitals, adoption agencies, churches, synagogues, YMCAs, and many other groups.

Global Connection

Nonprofits on a Global Scale Some nonprofit organizations focus on both local and global concerns. Recently, a global nonprofit organization, the Conservation International Foundation, joined efforts with one of the nation's largest coffee retailers to promote and sell "shade-grown coffee," which is currently grown in the Americas and other parts of the globe. In conjunction with the coffee retailer, this nonprofit organization is supporting a style of growing coffee that reduces the environmental impact of coffee growing in biologically sensitive regions. The foundation is also helping coffee growers sell directly to retailers, rather than through a third party. This arrangement brings greater profits to the coffee growers. **What are the local benefits of this program? What are the global benefits?**

The government exempts nonprofit organizations from income taxes. Many nonprofit organizations operate with partial government support. Almost all of them provide services rather than goods.

Other nonprofit organizations provide support to particular occupations or geographical areas. These include professional organizations, business associations, trade associations, and labor unions.

Professional Organizations

Professional organizations work to improve the image, working conditions, and skill levels of people in particular occupations. Examples include the National Education Association for public school and college

▲ **What might motivate these Red Cross volunteers?**

consumer cooperative *retail outlet owned and operated by consumers*

service cooperative *cooperative that provides a service, rather than a good*

producer cooperative *agricultural marketing cooperative that helps members sell their products*

nonprofit organization *institution that functions much like a business, but does not operate for the purpose of generating profits*

professional organization *nonprofit organization that works to improve the image, working conditions, and skill levels of people in particular occupations*

Many nonprofit organizations serve business interests.

business association *nonprofit organization that promotes collective business interests for a city, state, or other geographical area, or for a group of similar businesses*

trade association *nonprofit organization that promotes the interests of a particular industry*

and university workers, American Veterinary Medical Association for veterinary professionals, the American Bar Association for lawyers, and the American Management Association for business professionals.

Professional organizations keep their members up-to-date on industry trends. They help them identify and follow codes of conduct. For example, the American Medical Association opposes advertising. It believes that doctors present a less professional, authoritative, and caring image if they advertise for patients. Likewise, the American Bar Association frowns upon law firms that advertise their services for personal injury complaints.

Business Associations

Business associations promote the collective business interests of a city, state, or other geographical area, or of a group of similar businesses. They may also address codes of conduct, just as professional associations do.

Your local Better Business Bureau, sponsored by local businesses, is a nonprofit group. It aims to protect consumers by promoting an ethical and fair marketplace. Your state's or city's chamber of commerce works to attract new businesses to your area.

Trade Associations

Nonprofit organizations that promote the interests of particular industries are called **trade associations.** The American Marketing Association, for example, aims to improve marketers' and marketing firms' images. All kinds of industries, from publishing to food processing, enjoy the support of trade associations.

Labor Unions

A labor union is an organized group of workers whose aim is to improve working conditions, hours, wages, and fringe benefits. In the next chapter, you will read about the history and role of labor unions.

Section 4 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-3088

Key Terms and Main Ideas

1. How does a **business franchise** work?
2. What are **royalties?**
3. What is a **cooperative?**
4. How do **consumer cooperatives, service cooperatives,** and **producer cooperatives** differ?
5. What is a **nonprofit organization?**
6. What is the purpose of **professional organizations, business associations,** and **trade associations?**

Applying Economic Concepts

7. ***Critical Thinking*** Do you think the advantages of owning a franchise outweigh the disadvantages? Explain your reasoning.
8. ***Critical Thinking*** Do you think professional and business associations benefit consumers? Explain your reasoning.
9. ***Try This*** Make a list of the types of organizations described in this section. Next to each type, write down an example with which you are familiar.

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Real-life Case Study

Business and Ethics

When George Abbot Morison retired to the family farm in Peterborough, New Hampshire, in the 1940s, the state had high unemployment and very little industry. Morison decided to do something that would create new jobs and help revitalize the state's industrial base. He had read about Hitchiner Manufacturing Company, Inc., a small company that specialized in producing metal parts. Morison saw a growing need for precision metal parts and realized that Hitchiner's metal casting process had great commercial potential. In 1949, he and his son John H. Morison bought the company, and John became president.

Statement of Principles and Code of Conduct

We embrace responsibility.

We act in good faith, honestly and fairly.

We honor the law.

We nurture achievement.

We deliver quality and value.

We Respect the Earth.

We advance technology.

We are good citizens.

We guard our integrity.

Rights and Responsibilities For the Morisons' investment to pay off, they had to develop the company so that it would make money. To do so, they benefited from their rights to enter into contracts, to use the courts to enforce their contractual rights, and to receive equal protection of law.

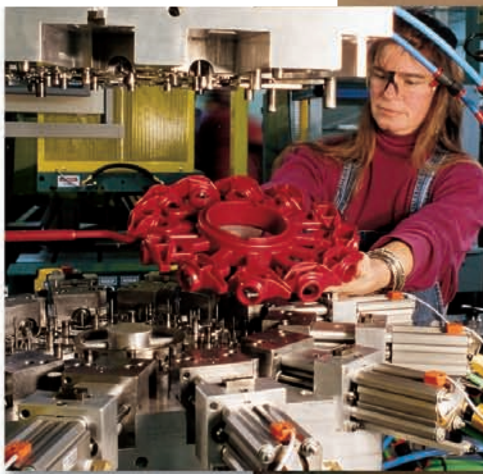
Hitchiner also had responsibilities. It had to comply with health and safety laws to reduce the chances of on-the-job injuries. The company had to pay employees at least minimum wage and had to make contributions to the state workers compensation fund. It also had to pay taxes on its profits.

Most importantly, the company strove to maintain "the highest standards of ethical and good-spirited conduct." Key points of its ethics policy appear in the Statement of Principles and Code of Conduct on this page.

Helping Employees Morison realized that the company's success depended on having an educated and trained work force. Hitchiner began sending employees for courses in many disciplines, from basic literacy and mathematics to statistical process control, for apprenticeships in specialized technical fields, and for business-management seminars. In 1953, Hitchiner became one of the first American companies to give its employees an ownership interest in the company.

Continued Success Today, Hitchiner markets its metal castings and licenses its technology and processes worldwide. Its current sales total about $200 million a year.

▼ Hitchiner uses the latest technologies in metal casting.



Applying Economic Ideas

1. **(a)** How were the Morisons able to help themselves and help their community at the same time? **(b)** What were their rights and responsibilities?

2. Analyze Hitchiner's ethics policy. Why was this policy an important part of its business success?

Chapter 8 Assessment

Chapter Summary

A summary of major ideas in Chapter 8 appears below. See also the **Guide to the Essentials of Economics,** which provides additional review and test practice of key concepts in Chapter 8.

Section 1 Sole Proprietorships (pp. 185–188)

Sole proprietorships are the most common form of business in the United States. They are easy to establish and offer owners both the benefits and drawbacks that come with full control of the business.

Section 2 Partnerships (pp. 190–193)

Partnerships let individuals pool their resources and share responsibility in the forming and running of a business. Three types of partnerships are the **general partnership,** the **limited partnership,** and the **limited liability partnership.**

Section 3 Corporations, Mergers, and Multinationals (pp. 195–200)

Corporations are complex business organizations that can be owned by a few or a great many individuals. **Mergers** combine corporations in various ways to form even larger businesses. Some corporate enterprises, the **multinationals,** span the globe.

Section 4 Other Organizations (pp. 201–204)

Business franchises are business organizations that give business owners support from a parent company. Other types of organizations serve to aid business owners, consumers, producers, industries, workers, or society at large. Many operate as **nonprofit organizations.**

Key Terms

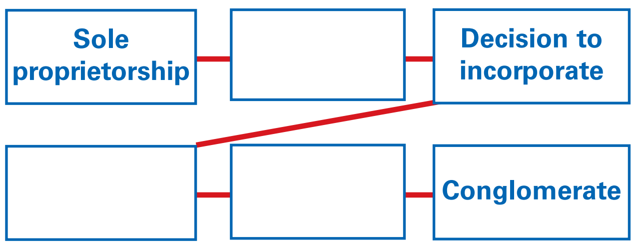
Match the following definitions with the terms listed below. You will not use all of the terms.

liability
corporation
conglomerate
general partnership
sole proprietorship
vertical merger
limited partnership
royalties
nonprofit organization
consumer cooperative

1. the combination of two or more firms involved in different stages of producing the same good or service
2. the legally bound obligation to pay debts
3. a legal entity owned by individual stockholders
4. a business owned and managed by a single individual
5. a retail outlet owned and operated by consumers
6. a business combination merging more than three businesses that make unrelated products
7. share of earnings given as payment
8. a form of partnership in which only one partner is required to be a general partner

Using Graphic Organizers

9. On a separate sheet of paper, copy the flowchart below. Use the flowchart to organize information about how a business might grow. Complete the flowchart by writing descriptions and examples for each cell in the chart. You may add cells to the chart.



Reviewing Main Ideas

10. List three trade-offs of running a sole proprietorship.
11. What are the advantages of forming a partnership when creating a new business?
12. What benefits do corporations bring to their stockholders?
13. Compare the advantages and disadvantages of opening a business franchise.
14. Describe the difference between vertical mergers, horizontal mergers, and conglomerates.
15. What are multinational corporations?
16. What are the advantages of cooperatives?
17. Identify and evaluate the ordinances and regulations that apply to the various types of businesses described in the chapter.

Critical Thinking

18. **Drawing Conclusions** Suppose you are opening a new business. List three choices that you would need to make to decide what style of business organization to form.
19. **Analyzing Information** How are the three types of corporate combinations usually affected by antitrust policy?
20. **Making Comparisons** Compare the different levels of individual liability among the three main types of business organizations: sole proprietorships, partnerships, and corporations.
21. **Drawing Inferences** How can stockholders influence the actions of the corporation they own?

Problem-Solving Activity

22. Recommend a cooperative for your community. Describe the type of cooperative it would be (consumer, service, or producer) and how your community could benefit from it.

Economics Journal

Identifying Alternatives Revisit your list of local businesses. Pick one and recommend a particular business form for it. Draft a proposal outlining why you think the business or the owner(s) would benefit from your plan.

Skills for Life

Using the Internet for Research Review the steps shown on page 194. Then complete the following activity.

Mergers lead to the formation of new business organizations. Corporate mergers sometimes have far-reaching effects on the companies and employees involved. Use the steps below to prepare a summary of one recent corporate merger and its effects on the employees of the companies involved.

23. **Prepare your search.** Identify one recent merger that has taken place. The Federal Trade Commission (FTC) oversees all mergers to make sure that they do not interfere with competition. Begin by visiting the FTC Web site. **(a)** How can you use the Internet to obtain information about these mergers? **(b)** List three key terms you might use in your search.
24. **Refine your search.** Once you have identified one merger to research, you need to refine your search. **(a)** How can you refine your search? **(b)** Identify two Internet sources that contain specific information about the merger.
25. **Analyze your results.** After you have located specific documents referring to the merger you have selected, you can begin to analyze the information. Print the documents if possible. **(a)** Look at the source of your documents. Could the source be biased? **(b)** What effect has the merger had on employees?

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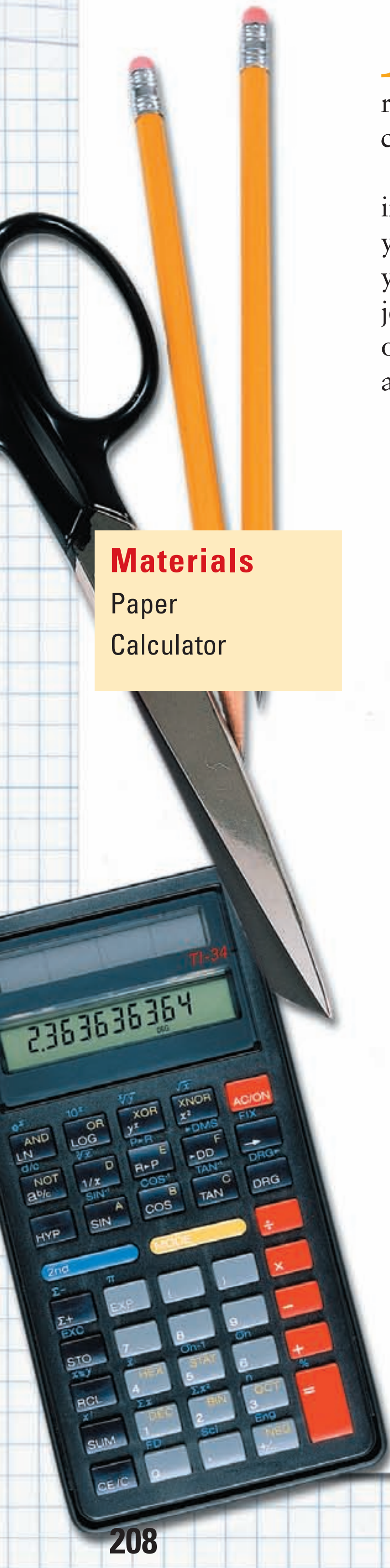
As a final review, take the Economics Chapter 8 Self-Test and receive immediate feedback on your answers. The test consists of 20 multiple-choice questions designed to test your understanding of the chapter content.

Economics Simulation

Be an Entrepreneur!

Many people dream of starting their own businesses. Here's your chance to practice doing just that. In this simulation, you and your classmates will form a partnership to run a small business. You plan to sell a line of souvenir baseball caps out of a rented vendor's cart in a nearby shopping mall.

Each partnership group will work independently. First, you will calculate your monthly costs. Then, you will price your product. Next, you will try to project how you would do in the first month of business. At the end of the simulation, all the partnerships will compare results.



Materials
Paper
Calculator

▲ Careful planning will improve your business's chances of success.

Preparing the Simulation

Step 1: Form groups of four to six people. Each group will be a separate business partnership.

Step 2: Choose a name for your company.

Conducting the Simulation

Step 1: Now, get started with your business plan! You and your partners already have $3,000 in start-up capital. Before you spend any of it, you need to figure out what your expenses will be. On a piece of paper, make a monthly expenses chart like the one on the next page. As you figure out each monthly expense, record it on the chart.

Business Loan Should you work within your $3,000 budget, or should you borrow money? You have learned that the best small-business loan that you qualify for charges an interest rate of 10% and requires monthly payments over 5 years:
$5,000 loan: $106 per month
$10,000 loan: $212 per month

Vendor License Your community requires you to get a vendor license. This will cost you $60 per year.

Banking Costs You need a business checking account. This will cost $12 per month.

Business Space The monthly rental costs for the vendor's cart depend on size and location:
Cart in well-traveled, central location: $2,000 per month
Cart in low-traffic area: $600 per month

Advertising Should you advertise? If you think you'll get enough "walk-in" traffic in the mall, you may not need to. Or, you may want to be more aggressive and use advertising to bring people directly to you:
Medium-sized ad in the major city newspaper: $400 per week
Small ad in neighborhood newspaper: $40 per week

Labor Should you and your partners work the cart, or should you hire a salesperson? Your vendor's cart will need to be staffed from 9:30 A.M. to 9:30 P.M. If you hire a salesperson, you will need to pay wages plus another 25 percent for benefits and taxes. Use the following formula:

Number of hours per month $\times$ hourly wage $\times$ 1.25 = total monthly labor cost

Step 2: Now you need to make decisions about your inventory. How many caps will you order from the manufacturer? Refer to the catalog page at right to determine which kind you'll order. Make an order/pricing form like the one on this page, and record the quantities and costs of the caps you want to buy.

Step 3: Next, you need to set a price for your caps. Keep in mind what the caps cost you and what you think people will pay for them. Add the prices to the order/pricing form and calculate your profit per cap.

Step 4: Finally, you need to determine how many caps you need to sell in order to make a profit after having paid your monthly expenses. Assume, for the moment, that you sell equal numbers of each cap. How many caps do you need to sell each month to break even? How many do you need to sell to make a profit large enough to pay salaries to you and your partners?

Step 5: Present your business plan to the rest of your class.

Monthly Expenses for Cap Business

Expense	Monthly Expense
Banking Costs	$
Loan Repayment	$
Vendor's License	$
Business Space	$
Advertising	$
Labor	$
Total Monthly Expenses	**$**

Good Quality! Cotton caps with plastic snap tabs
Colors: khaki, green, blue, charcoal, red

Item Number	Quantity	Price per cap
Style 101	100	$2.53
Silk Screened	500	$2.37
	1,000	$2.09
Style 102	100	$5.20
Embroidered	500	$4.82
	1,000	$4.60

Best Quality! Cotton twill caps with adjustable leather strap and brass buckle
Colors: black, white, navy blue, pine green

Item Number	Quantity	Price per cap
Style 202	100	$6.05
Embroidered	500	$5.60
	1,000	$5.40

Simulation Analysis

After all the partnerships in your class have presented their business plans, answer the following questions.

1. Which business plan was the most cautious? Which group took the most chances?
2. Where do you get the greatest savings for additional quantities—the least-expensive or most-expensive caps?
3. Suppose that you began the first month with equal numbers of silk-screened and embroidered caps. At the end of the month, you sold out of caps with silk-screened designs but had 20 embroidered caps left. What would this tell you about your market?
4. **Formulating Questions** What other information would you need if you were actually going to set up a small business?