

EXPLORING BUSINESS



Exploring Business

Anonymous

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This text was compiled on 04/10/2025

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1.1: Introduction

As the story of Apple suggests, today is an interesting time to study business. Advances in technology are bringing rapid changes in the ways we produce and deliver goods and services. The Internet and other improvements in communication (such as smartphones, video conferencing, and social networking) now affect the way we do business. Companies are expanding international operations, and the workforce is more diverse than ever. Corporations are being held responsible for the behavior of their executives, and more people share the opinion that companies should be good corporate citizens. Plus—and this is a big plus—businesses today are facing the lingering effects of what many economists believe is the worst financial crisis since the Great Depression (Hilsenrath, et. al., 2008). Economic turmoil that began in the housing and mortgage industries as a result of troubled subprime mortgages quickly spread to the rest of the economy. In 2008, credit markets froze up and banks stopped making loans. Lawmakers tried to get money flowing again by passing a \$700 billion Wall Street bailout, yet businesses and individuals were still denied access to needed credit. Without money or credit, consumer confidence in the economy dropped and consumers cut back their spending. Businesses responded by producing fewer products, and their sales and profits dropped. Unemployment rose as troubled companies shed the most jobs in five years, and 760,000 Americans marched to the unemployment lines¹. The stock market reacted to the financial crisis and its stock prices dropped by 44 percent while millions of Americans watched in shock as their savings and retirement accounts took a nose dive. In fall 2008, even Apple, a company that had enjoyed strong sales growth over the past five years, began to cut production of its popular iPhone. Without jobs or cash, consumers would no longer flock to Apple's fancy retail stores or buy a prized iPhone (Gallagher, 2008). Things have turned around for Apple, which reported blockbuster sales for 2011 in part because of strong customer response to the iPhone 4S. But not all companies or individuals are doing so well. The economy is still struggling, unemployment is high (particularly for those ages 16 to 24), and home prices remain low.

As you go through the course with the aid of this text, you'll explore the exciting world of business. We'll introduce you to the various activities in which businesspeople engage—accounting, finance, information technology, management, marketing, and operations. We'll help you understand the roles that these activities play in an organization, and we'll show you how they work together. We hope that by exposing you to the things that businesspeople do, we'll help you decide whether business is right for you and, if so, what areas of business you'd like to study further.

¹"How the Economy Stole the Election," *CNN.com*, http://money.cnn.com/galleries/2008/news/0810/gallery.economy_election/index.html (accessed January 21, 2012).

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Hilsenrath, J., Serena Ng, and Damian Paletta, "Worst Crisis Since '30s, With No End Yet in Sight," *Wall Street Journal*, Markets, September 18, 2008, <http://online.wsj.com/article/SB122169431617549947.html> (accessed January 21, 2012).

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1.2: Getting Down to Business

Learning Objective

1. Identify the main participants of business, the functions that most businesses perform, and the external forces that influence business activities.

A business is any activity that provides goods or services to consumers for the purpose of making a profit. When Steve Jobs and Steve Wozniak created Apple Computer in Jobs's family garage, they started a business. The product was the Apple I, and the company's founders hoped to sell their computers to customers for more than it cost to make and market them. If they were successful (which they were), they'd make a profit.

Before we go on, let's make a couple of important distinctions concerning the terms in our definitions. First, whereas Apple produces and sells *goods* (Mac, iPhone, iPod, iPad), many businesses provide *services*. Your bank is a service company, as is your Internet provider. Hotels, airlines, law firms, movie theaters, and hospitals are also service companies. Many companies provide both goods and services. For example, your local car dealership sells goods (cars) and also provides services (automobile repairs).

Second, some organizations are not set up to make profits. Many are established to provide social or educational services. Such not-for-profit (or nonprofit) organizations include the United Way of America, Habitat for Humanity, the Boys and Girls Clubs, the Sierra Club, the American Red Cross, and many colleges and universities. Most of these organizations, however, function in much the same way as a business. They establish goals and work to meet them in an effective, efficient manner. Thus, most of the business principles introduced in this text also apply to nonprofits.

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1.3: What Is Economics?

Learning Objectives

1. Define *economics* and identify factors of production.
2. Explain how economists answer the three key economics questions.
3. Compare and contrast economic systems.

To appreciate how a business functions, we need to know something about the economic environment in which it operates. We begin with a definition of economics and a discussion of the resources used to produce goods and services.

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1.4: Perfect Competition and Supply and Demand

Learning Objective

1. Describe perfect competition, and explain how supply and demand interact to set prices in a free market system.

Under a mixed economy, such as we have in the United States, businesses make decisions about which goods to produce or services to offer and how they are priced. Because there are many businesses making goods or providing services, customers can choose among a wide array of products. The competition for sales among businesses is a vital part of our economic system. Economists have identified four types of competition—*perfect competition*, *monopolistic competition*, *oligopoly*, and *monopoly*. We'll introduce the first of these—perfect competition—in this section and cover the remaining three in the following section.

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1.5: Monopolistic Competition, Oligopoly, and Monopoly

Learning Objective

1. Describe monopolistic competition, oligopoly, and monopoly.

Economists have identified four types of competition—*perfect competition*, *monopolistic competition*, *oligopoly*, and *monopoly*. Perfect competition was discussed in the last section; we'll cover the remaining three types of competition here.

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1.6: Measuring the Health of the Economy

Learning Objective

1. Understand the criteria used to assess the status of the economy.

Every day, we are bombarded with economic news. We're told that the economy is struggling, unemployment is high, home prices are low, and consumer confidence is down. As a student learning about business, and later as a business manager, you need to understand the nature of the U.S. economy and the terminology that we use to describe it. You need to have some idea of where the economy is heading, and you need to know something about the government's role in influencing its direction.

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1.7: Government's Role in Managing the Economy

Learning Objective

1. Discuss the government's role in managing the economy.

In every country, the government takes steps to help the economy achieve the goals of growth, full employment, and price stability. In the United States, the government influences economic activity through two approaches: monetary policy and fiscal policy. Through monetary policy, the government exerts its power to regulate the money supply and level of interest rates. Through fiscal policy, it uses its power to tax and to spend.

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1.8: Cases and Problems

Learning on the Web (AACSB)

The “Economy” section of the CNNMoney Web site provides current information on a number of economic indicators. Go to money.cnn.com and click on “Economy” and then on “Jobs,” and find answers to the following questions:

1. You read in the chapter that an important goal of all economies is to make jobs available to everyone who wants one. Review the CNNMoney discussion on job growth and then answer the following questions:
 - a. Is the current level of unemployment rising or falling?
 - b. What do economists expect will happen to unemployment rates in the near future?
 - c. Is the current level of unemployment a burden or an asset to the economy? In what ways?
2. Do you remember the first dollar you earned? Maybe you earned it delivering newspapers, shoveling snow, mowing lawns, or babysitting. How much do you think that dollar is worth today? Go to the WestEgg site at <http://www.westegg.com/inflation> and find the answer to this question. After determining the current value of your first dollar, explain how the calculator was created. (*Hint:* Apply what you know about CPI.)

Career Opportunities

Is a Career in Economics for You?

Are you wondering what a career in economics would be like? Go to the U.S. Department of Labor Web site (www.bls.gov/oco/ocos055.htm) and review the occupational outlook for economists. Look for answers to the following questions:

1. What issues interest economists?
2. What kinds of jobs do government economists perform? What about those who work in private industry? In education?
3. What educational background and training is needed for these jobs?
4. What is the current job outlook for economists?
5. What is the entry-level salary for an economist with a bachelor’s degree? With a master’s degree?

Ethics Angle (AACSB)

How Much Is That CD in the Window?

The early 1990s were a good time to buy CDs, mainly because discounters such as Wal-Mart and Best Buy were accumulating customers by dropping prices from \$15 to \$10. They were losing money, but they figured that the policy still made good business sense. Why? They reasoned that while customers were in the store to shop for CDs, they’d find other, more profitable products.

The policy was a windfall for CD buyers, but a real problem for traditional music retailers such as Tower Records. With discounters slashing prices, CD buyers were no longer willing to pay the prices asked by traditional music retailers. Sales plummeted and companies went out of business.

Ultimately, the discounters’ strategy worked: stores such as Wal-Mart and Best Buy gained customers who once bought CDs at stores like Tower Records.

Let’s pause at this point to answer the following questions:

1. Does selling a product at below cost make business sense?
2. Whom does it hurt? Whom does it help?
3. Is it ethical?

Let’s continue and find out how traditional music retailers responded to this situation.

They weren’t happy, and neither were the record companies. Both parties worried that traditional retailers would put pressure on them to reduce the price that they charged for CDs so that retailers could lower their prices and compete with discounters. The record companies didn’t want to lower prices. They just wanted things to return to “normal”—to the world in which CDs sold for \$15 each.

Most of the big record companies and several traditional music retailers got together and made a deal affecting every store that sold CDs. The record companies agreed with retail chains and other CD outlets to charge a minimum advertised price for CDs. Any

retailer who broke ranks by advertising below-price CDs would incur substantial financial penalties. Naturally, CD prices went up. Now, think about the following:

1. Does the deal made between the record companies and traditional retailers make business sense?
2. Whom does it hurt? Whom does it help?
3. Is it ethical?
4. Is it legal?

Team-Building Skills (AACSB)

Get together in groups of four selected by your instructor and pick any three items from the following list:

- Pint of milk
- Gallon of gas
- Roundtrip airline ticket between Boston and San Francisco
- Large pizza
- Monthly cost of an Internet connection
- CD by a particular musician
- Two-day DVD rental
- Particular brand of DVD player
- Quarter-pound burger

Outside of class, each member of the team should check the prices of the three items, using his or her own sources. At the next class meeting, get together and compare the prices found by team members. Based on your findings, answer the following questions as a group:

1. Are the prices of given products similar, or do they vary?
2. Why do the prices of some products vary while those of others are similar?
3. Can any price differences be explained by applying the concepts of supply and demand or types of competition?

The Global View (AACSB)

Life Is Good in France (if You Have *Le Job*)

A strong economy requires that people have money to spend on goods and services. Because most people earn their money by working, an important goal of all economies is making jobs available to everyone who wants one. A country has “full employment” when 95 percent of those wanting work are employed. Unfortunately, not all countries achieve this goal of full employment. France, for example, often has a 10 percent unemployment rate overall and a 20 percent unemployment rate among young people.

Does this mean that France isn’t trying as hard as the United States to achieve full employment? A lot of people in France would say yes.

Let’s take a quick trip to France to see what’s going on economically. The day is March 19, 2006, and more than a million people are marching through the streets to protest a proposed new employment law that would make it easier for companies to lay off workers under the age of twenty-six during their first two years of employment. Granted, the plan doesn’t sound terribly youth-friendly, but, as usual, economic issues are never as clear-cut as they seem (or as we’d like them to be).

To gain some further insight into what’s going on in France, go to a *BusinessWeek* Web site (http://www.businessweek.com/globalbiz/content/mar2006/gb20060321_896473.htm) and read the article “Job Security Ignites Debate in France.” Then answer the following questions:

1. Why does the French government support the so-called First Employment Contract? Who’s supposed to be helped by the law?
2. Which two groups are most vocal in protesting the law? Why?
3. If you were a long-time worker at a French company, would you support the new law? Why, or why not?
4. If you were a young French person who had just graduated from college and were looking for your first job, would you support the law? Why, or why not?
5. What do you think of France’s focus on job security? Does the current system help or hurt French workers? Does it help or hurt recent college graduates?

6. Does the French government's focus on job security help or hinder its economy? Should the government be so heavily involved in employment matters?

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CHAPTER OVERVIEW

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2.1: Misgoverning Corporations- An Overview

Learning Objectives

1. Define business ethics and explain what it means to act ethically in business.
2. Explain how you can recognize an ethical organization.

The WorldCom situation is not an isolated incident. The boom years of the 1990s were followed by revelations of massive corporate corruption, including criminal schemes at companies such as Enron, Adelphia, and Tyco. In fall 2001, executives at Enron, an energy supplier, admitted to accounting practices concocted to overstate the company's income over a period of four years. In the wake of the company's collapse, stock prices plummeted from \$90 to \$1 a share, inflicting massive financial losses on the investment community. Thousands of employees lost not only their jobs but their retirement funds, as well (Kadlec, 2002). Before the Enron story was off the front pages, officials at Adelphia, the nation's sixth-largest cable company, disclosed that founder and CEO John Rigas had treated the publicly owned firm as a personal piggy bank, siphoning off billions of dollars to support his family's extravagant lifestyle and bankrupting the company in the process (Lieberman, 2004). Likewise, CEO Dennis Koslowzki of conglomerate Tyco International was apparently confused about what was his and what belonged to the company. Besides treating himself to a \$30 million estate in Florida and a \$7 million Park Avenue apartment, Koslowzki indulged in a taste for expensive office accessories—such as a \$15,000 umbrella stand, a \$17,000 traveling toilette box, and a \$2,200 wastebasket—that eventually drained \$600 million from company coffers¹.

As crooked as these CEOs were, Bernie Madoff, founder of Bernard L. Madoff Investment Securities and former chairman of the NASDAQ stock exchange, makes them seem like dime-store shoplifters². Madoff is alleged to have run a giant Ponzi scheme (Langan, 2008) that cheated investors of up to \$65 billion. His wrongdoings won him a spot at the top of *Time Magazine's* Top 10 Crooked CEOs. According to the SEC charges, Madoff convinced investors to give him large sums of money. In return, he gave them an impressive 8 percent to 12 percent return a year. But Madoff never really invested their money. Instead, he kept it for himself. He got funds to pay the first investors their return (or their money back if they asked for it) by bringing in new investors. Everything was going smoothly until the fall of 2008, when the stock market plummeted and many of his investors asked for their money back. As he no longer had their money, the game was over and he had to admit that the whole thing was just one big lie. Thousands of investors, including many of his wealthy friends, not-so-rich retirees who trusted him with their life savings, and charitable foundations, were financially ruined. All those harmed by Madoff either directly or indirectly were pleased when he was sentenced to jail for one-hundred and fifty years.

Are these cases merely aberrations? A *Time/CNN* poll conducted in the midst of all these revelations found that 72 percent of those surveyed don't think so. They believe that breach of investor and employee trust represents an ongoing, long-standing pattern of deceptive behavior by officials at a large number of companies (Gibbs, et. al., 2002). If they're right, then a lot of questions need to be answered. Why do such incidents happen (and with such apparent regularity)? Who are the usual suspects? How long until the next corporate bankruptcy record is set? What action can be taken—by individuals, organizations, and the government—to discourage such behavior?

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2.2: The Individual Approach to Ethics

Learning Objective

1. Specify the steps that you would take to solve an ethical dilemma and make an ethical decision.

Betty Vinson didn't start out at WorldCom with the intention of going to jail. She undoubtedly knew what the right behavior was, but the bottom line is that she didn't *do* it. How can you make sure that you do the right thing in the business world? How should you respond to the kinds of challenges that you'll be facing? Because your actions in the business world will be strongly influenced by your moral character, let's begin by assessing your current moral condition. Which of the following best applies to you (select one)?

1. I'm always ethical.
2. I'm mostly ethical.
3. I'm somewhat ethical.
4. I'm seldom ethical.
5. I'm never ethical.

Now that you've placed yourself in one of these categories, here are some general observations. Few people put themselves below the second category. Most of us are ethical most of the time, and most people assign themselves to category number two—"I'm *mostly* ethical." Why don't more people claim that they're *always* ethical? Apparently, most people realize that being ethical all the time takes a great deal of moral energy. If you placed yourself in category number two, ask yourself this question: How can I change my behavior so that I can move up a notch? The answer to this question may be simple. Just ask yourself an easier question: How would I like to be treated in a given situation (Maxwell, 2003)?

Unfortunately, practicing this philosophy might be easier in your personal life than in the business world. Ethical challenges arise in business because business organizations, especially large ones, have multiple stakeholders and because stakeholders make conflicting demands. Making decisions that affect multiple stakeholders isn't easy even for seasoned managers; and for new entrants to the business world, the task can be extremely daunting. Many managers need years of experience in an organization before they feel comfortable making decisions that affect various stakeholders. You can, however, get a head start in learning how to make ethical decisions by looking at two types of challenges that you'll encounter in the business world: *ethical dilemmas* and *ethical decisions*.

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2.3: Identifying Ethical Issues

Learning Objective

1. Identify ethical issues that you might face in business, and analyze rationalizations for unethical behavior.

Make no mistake about it: When you enter the business world, you'll find yourself in situations in which you'll have to choose the appropriate behavior. How, for example, would you answer questions like the following?

- Is it OK to accept a pair of sports tickets from a supplier?
- Can I buy office supplies from my brother-in-law?
- Is it appropriate to donate company funds to my local community center?
- If I find out that a friend is about to be fired, can I warn her?
- Will I have to lie about the quality of the goods I'm selling?
- Can I take personal e-mails and phone calls at work?
- What do I do if I discover that a coworker is committing fraud?

Obviously, the types of situations are numerous and varied. Fortunately, we can break them down into a few basic categories: *bribes, conflicts of interest, conflicts of loyalty, issues of honesty and integrity, and whistle-blowing*. Let's look a little more closely at each of these categories.

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2.4: The Organizational Approach to Ethics

Learning Objective

1. Specify actions that managers can take to create and sustain ethical organizations.

Ethics is more than a matter of individual behavior; it's also about organizational behavior. Employees' actions aren't based solely on personal values alone: They're influenced by other members of the organization, from top managers and supervisors to coworkers and subordinates. So how can ethical companies be created and sustained? In this section, we'll examine some of the most reasonable answers to this question.

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2.5: Corporate Social Responsibility

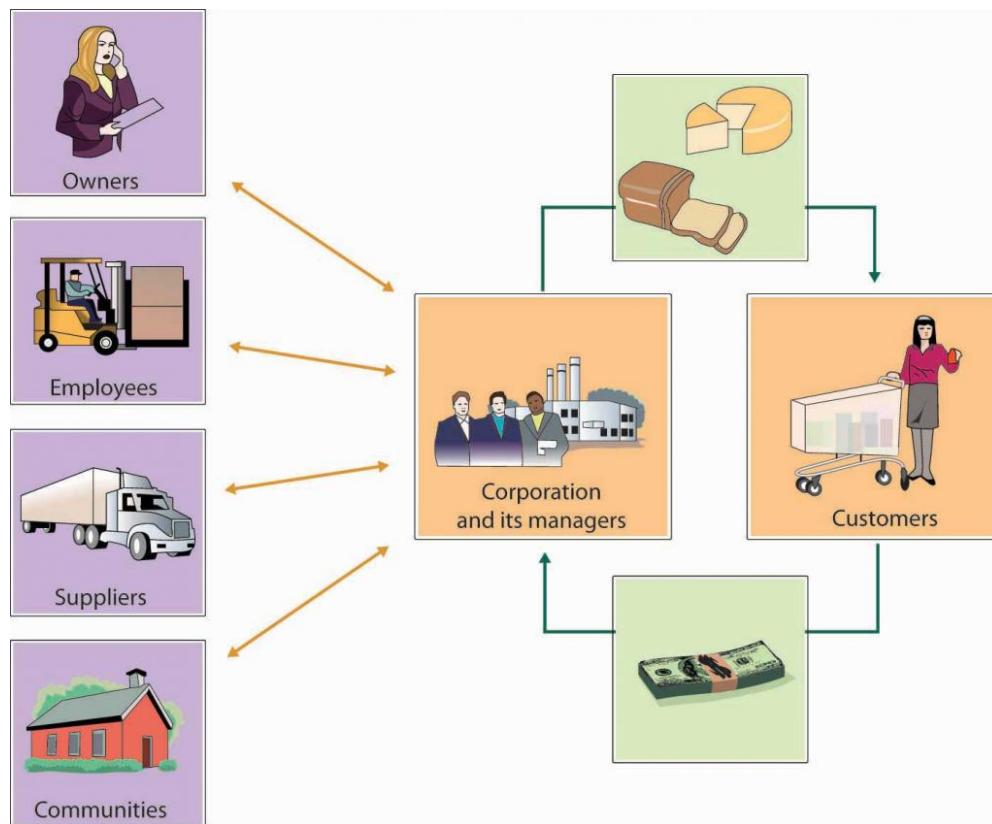
Learning Objective

- Define *corporate social responsibility* and explain how organizations are responsible to their stakeholders.

Corporate social responsibility refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economic, ethical, and social decisions. What motivates companies to be “socially responsible” to their various stakeholders? We hope it’s because they want to do the right thing, and for many companies, “doing the right thing” is a key motivator. The fact is, it’s often hard to figure out what the “right thing” is: What’s “right” for one group of stakeholders isn’t necessarily just as “right” for another. One thing, however, is certain: Companies today are held to higher standards than ever before. Consumers and other groups consider not only the quality and price of a company’s products but also its character. If too many groups see a company as a poor corporate citizen, it will have a harder time attracting qualified employees, finding investors, and selling its products. Good corporate citizens, by contrast, are more successful in all these areas.

Figure 2.6 “The Corporate Citizen” presents a model of corporate responsibility based on a company’s relationships with its *stakeholders*. In this model, the focus is on managers—not owners—as the principals involved in all these relationships. Here, owners are the stakeholders who invest risk capital in the firm in expectation of a financial return. Other stakeholders include employees, suppliers, and the communities in which the firm does business. Proponents of this model hold that customers, who provide the firm with revenue, have a special claim on managers’ attention. The arrows indicate the two-way nature of corporation-stakeholder relationships: All stakeholders have some claim on the firm’s resources and returns, and it’s management’s job to make decisions that balance these claims (Baron, D. P., 2003).

Figure 2.6 The Corporate Citizen



Let’s look at some of the ways in which companies can be “socially responsible” in considering the claims of various stakeholders.

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2.6: Environmentalism

Learning Objectives

1. Identify threats to the natural environment, and explain how businesses are addressing them.
2. Define sustainability and understand why companies are now focusing on environmental and socially responsibility issues.

Today, virtually everyone agrees that companies must figure out how to produce products without compromising the right of future generations to meet their own needs. Clearly, protecting natural resources is the right thing to do, but it also has become a business necessity. Companies' customers demand that they respect the environment. Let's identify some key environmental issues and highlight the ways in which the business community has addressed them.

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2.7: Stages of Corporate Responsibility

Learning Objective

1. List the stages of corporate responsibility.

We expect companies to recognize issues of social importance and to address them responsibly. The companies that do this earn reputations as good corporate citizens and enjoy certain benefits, such as the ability to keep satisfied customers, to attract capital, and to recruit and retain talented employees. But companies don't become good corporate citizens overnight. Learning to identify and develop the capacity to address social concerns takes time and requires commitment. The task is arduous because so many different issues are important to so many different members of the public—issues ranging from the environment, to worker well-being (both at home and abroad), to fairness to customers, to respect for the community in which a company operates.

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2.8: Cases and Problems

Learning on the Web (AACSB)

Lessons in Community Living

Executives consider it an honor to have their company named one of *Business Ethics* magazine's "100 Best Corporate Citizens." Companies are chosen from a group of one thousand, according to how well they serve their stakeholders—owners, employees, customers, and the communities with which they share the social and natural environment. Being in the top one hundred for five years in a row is cause for celebration. Two of the twenty-nine companies that enjoy this distinction are Timberland and the New York Times Company.

The two companies are in very different industries. Timberland designs and manufactures boots and other footwear, apparel, and accessories; the New York Times Company is a media giant, with nineteen newspapers (including the *New York Times* and the *Boston Globe*), eight television stations, and more than forty Web sites. Link to the Timberland Web site (<http://www.timberland.com/corp/index...ge=csroverview>) and the New York Times Company Web site (www.nytco.com/social_responsibility/index.html) to learn how each, in its own way, supports the communities with which it shares the social and natural environment. Look specifically for information that will help you answer the following questions:

1. How does each company assist its community? To what organizations does each donate money? How do employees volunteer their time? What social causes does each support?
2. How does each company work to protect the natural environment?
3. Are the community-support efforts of the two companies similar or dissimilar? In what ways do these activities reflect the purposes of each organization?
4. In your opinion, why do these companies support their communities? What benefits do they derive from being good corporate citizens?

Career Opportunities

Is "WorldCom Ethics Officer" an Oxymoron?

As you found out in this chapter, WorldCom's massive accounting scandal cost investors billions and threw the company into bankruptcy. More than one hundred employees who either participated in the fraud or passively looked the other way were indicted or fired, including accountant Betty Vinson, CFO Scott Sullivan, and CEO Bernard Ebbers. With the name "WorldCom" indelibly tarnished, the company reclaimed its previous name, "MCI." It was put on court-imposed probation and ordered to follow the directives of the court. One of those directives called for setting up an ethics office. Nancy Higgins, a corporate attorney and onetime vice president for ethics at Lockheed Martin, was brought in with the title of chief ethics officer.

Higgins's primary responsibility is to ensure that MCI lives up to new CEO Michael Capellas's assertion that the company is dedicated to integrity and its employees are committed to high ethical standards. Her tasks are the same as those of most people with the same job title, but she's under more pressure because MCI can't afford any more ethical lapses. She oversees the company's ethics initiatives, including training programs and an ethics hotline. She spends a lot of her time with employees, listening to their concerns and promoting company values.

Higgins is a member of the senior executive team and reports to the CEO and board of directors. She attends all board meetings and provides members with periodic updates on the company's newly instituted ethics program (including information gleaned from the new ethics hotline).

Answer the following questions:

1. Would you be comfortable in Higgins's job? Does the job of ethics officer appeal to you? Why, or why not?
2. Would you find it worthwhile to work in an ethics office for a few years at some point in your career? Why, or why not?
3. What qualities would you look for if you were hiring an ethics officer?
4. What factors will help (or hinder) Higgins's ability to carry out her mandate to bolster integrity and foster ethical standards?
5. Would the accounting scandals have occurred at WorldCom if Higgins had been on the job back when Vinson, Sullivan, and Ebbers were still there? Explain your opinion.

Team-Building Skills (AACSB)

What Are the Stakes When You Play with Wal-Mart?

In resolving an ethical dilemma, you have to choose between two or more opposing alternatives, both of which, while acceptable, are important to different groups. Both alternatives may be ethically legitimate, but you can act in the interest of only one group.

This project is designed to help you learn how to analyze and resolve ethical dilemmas in a business context. You'll work in teams to address three ethical dilemmas involving Wal-Mart, the world's largest company. Before meeting as a group, every team member should go to the *BusinessWeek* Web site (http://www.businessweek.com/magazine...2001_mz001.htm) and read "Is Wal-Mart Too Powerful?" The article discusses Wal-Mart's industry dominance and advances arguments for why the company is both admired and criticized.

Your team should then get together to analyze the three dilemmas that follow. Start by reading the overview of the dilemma and any assigned material. Then debate the issues, working to reach a resolution through the five-step process summarized in Figure 2.2 "How to Face an Ethical Dilemma":

1. Define the problem and collect the relevant facts.
2. Identify feasible options.
3. Assess the effect of each option on stakeholders.
4. Establish criteria for determining the most appropriate action.
5. Select the best option based on the established criteria.

Finally, prepare a report on your deliberations over each dilemma, making sure that each report contains all the following items:

- The team's recommendation for resolving the dilemma
- An explanation of the team's recommendation
- A summary of the information collected for, and the decisions made at, each step of the dilemma-resolution process

Three Ethical Dilemmas

Ethical Dilemma 1: Should Wal-Mart Close a Store because It Unionizes?

Scenario:

In February 2005, Wal-Mart closed a store in Quebec, Canada, after its workers voted to form a union. The decision has ramifications for various stakeholders, including employees, customers, and stockholders. In analyzing and arriving at a resolution to this dilemma, assume that you're the CEO of Wal-Mart, but *ignore the decision already made by the real CEO*. Arrive at your own recommendation, which may or may not be the same as that reached by your real-life counterpart.

Before analyzing this dilemma, go to the *Washington Post* Web site (www.washingtonpost.com/wp-dyn...2005Feb10.html) and read the article "Wal-Mart Chief Defends Closing Unionized Store."

Ethical Dilemma 2: Should Levi Strauss Go into Business with Wal-Mart?

Scenario:

For years, the words *jeans* and *Levi's* were synonymous. Levi Strauss, the founder of the company that carries his name, invented blue jeans in 1850 for sale to prospectors in the gold fields of California. Company sales peaked at \$7 billion in 1996 but then plummeted to \$4 billion by 2003. Management has admitted that the company must reverse this downward trend if it hopes to retain the support of its twelve thousand employees, operate its remaining U.S. factories, and continue its tradition of corporate-responsibility initiatives. At this point, Wal-Mart made an attractive offer: Levi Strauss could develop a low-cost brand of jeans for sale at Wal-Mart. The decision, however, isn't as simple as it may seem: Wal-Mart's relentless pressure to offer "everyday low prices" can have wide-ranging ramifications for its suppliers' stakeholders—in this case, Levi Strauss's shareholders, employees, and customers, as well as the beneficiaries of its various social-responsibility programs. Assume that, as the CEO of Levi Strauss, you have to decide whether to accept Wal-Mart's offer. Again, ignore any decision already made by your real-life counterpart, and instead work toward an independent recommendation.

Before you analyze this dilemma, go to the *Fast Company* Web site (<http://www.fastcompany.com/magazine/77/walmart.html>) and read the article "The Wal-Mart You Don't Know."

Ethical Dilemma 3: Should You Welcome Wal-Mart into Your Neighborhood?

Scenario:

In 2002, Wal-Mart announced plans to build forty “supercenters” in California—a section of the country that has traditionally resisted Wal-Mart’s attempts to dot the landscape with big-box stores. Skirmishes soon broke out in California communities between those in favor of welcoming Wal-Mart and those determined to fend off mammoth retail outlets.

You’re a member of the local council of a California city, and you’ll be voting next week on whether to allow Wal-Mart to build in your community. The council’s decision will affect Wal-Mart, as well as many local stakeholders, including residents, small business owners, and employees of community supermarkets and other retail establishments. As usual, ignore any decisions already made by your real-life counterparts.

Before working on this dilemma, go to the *USA Today* Web site (http://www.usatoday.com/money/indust...wal-mart_x.htm) and read the article “California Tries to Slam Lid on Big-Boxed Wal-Mart.”

The Global View (AACSB)

Was Nike Responsible for Compensating Honduran Factory Workers?

Honduras is an impoverished country in which 70% of its residents live in poverty. Jobs are scarce, particularly those that pay decent wages along with benefits, such as health care. It is not surprising then that workers at two Honduran factories making products for U.S. companies, including Nike, were extremely upset when their factories closed down and they lost their jobs. Even worse, the owners of the factories refused to pay the 1,800 workers \$2 million in severance pay and other benefits due to them by law. Although the factory owners had been paid in full by Nike for the apparel they produced, the workers argued that Nike should be responsible for paying the \$2 million in severance that the factory owners had not received.

Nike’s original response was to sympathize with the workers but refuse to pay the workers the severance pay they had not received from the factory owners. This stance did not settle well with student groups around the country who rallied in support of the unpaid workers. In the end Nike gave into pressure from the students and paid \$1.5 million to a relief fund for the employees. In addition, the company said it would provide vocational training and health coverage for the unemployed workers.

To learn more about this case, read the following:

- Nike Press Release: Nike Statement Regarding Vision Tex and Hugger (April 20, 2010)
www.nikebiz.com/media/pr/2010...rHonduras.html
- Working in These Times: Honduran Workers Speak Out Against Nike’s Labor Violations (April 21, 2010)
http://inthesetimes.org/working/entr...or_violations/
- New York Times: Pressured, Nike to Help Workers in Honduras (July 26, 2010)
<http://www.nytimes.com/2010/07/27/bu...al/27nike.html>
- Time Magazine: Just Pay It: Nike Creates Fund for Honduran Workers (July 27, 2010)
www.time.com/time/printout/0,...006646,00.html
- Nike Press Release: Nike and CGT Statement (July 26, 2010) www.nikebiz.com/media/pr/2010...statement.html

Answer the following questions:

1. Do you think Nike was responsible for compensating the workers in Honduras? Why did it change its stance?
2. Did the students, universities, and workers themselves have all of the information they needed before becoming involved in the protest? Are their facts accurate?
3. Should students be activists? Do companies such as Nike ignore them at their own peril?

CHAPTER OVERVIEW

3: Business in a Global Environment

- 3.1: The Globalization of Business
- 3.2: Opportunities in International Business
- 3.3: The Global Business Environment
- 3.4: Trade Controls
- 3.5: Reducing International Trade Barriers
- 3.6: Preparing for a Career in International Business
- 3.7: Cases and Problems

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3.1: The Globalization of Business

Learning Objectives

1. Explain why nations and companies participate in international trade.
2. Describe the concepts of absolute and comparative advantage.
3. Explain how trade between nations is measured.

The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's highly likely that you'll meet and work with individuals from various countries and cultures as customers, suppliers, colleagues, employees, or employers. The bottom line is that the globalization of world commerce has an impact on all of us. Therefore, it makes sense to learn more about how globalization works.

Figure 3.1



World commerce has become increasingly international, so understanding how global business works is key to a successful career.

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3.2: Opportunities in International Business

Learning Objectives

1. Define importing and exporting.
2. Explain how companies enter the international market through licensing agreements or franchises.
3. Describe how companies reduce costs through contract manufacturing and outsourcing.
4. Explain the purpose of international strategic alliances and joint ventures.
5. Understand how U.S. companies expand their businesses through foreign direct investments and international subsidiaries.
6. Understand the arguments for and against multinational corporations.

The fact that nations exchange billions of dollars in goods and services each year demonstrates that international trade makes good economic sense. For an American company wishing to expand beyond national borders, there are a variety of ways it can get involved in international business. Let's take a closer look at the more popular ones.

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3.3: The Global Business Environment

Learning Objective

1. Appreciate how cultural, economic, legal, and political differences between countries create challenges to successful business dealings.

In the classic movie *The Wizard of Oz*, a magically misplaced Midwest farm girl takes a moment to survey the bizarre landscape of Oz and then comments to her little dog, “I don’t think we’re in Kansas anymore, Toto.” That sentiment probably echoes the reaction of many businesspeople who find themselves in the midst of international ventures for the first time. The differences between the foreign landscape and the one with which they’re familiar are often huge and multifaceted. Some are quite obvious, such as differences in language, currency, and everyday habits (say, using chopsticks instead of silverware). But others are subtle, complex, and sometimes even hidden. Success in international business means understanding a wide range of cultural, economic, legal, and political differences between countries. Let’s look at some of the more important of these differences.

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3.4: Trade Controls

Learning Objective

1. Describe the ways in which governments and international bodies promote and regulate global trade.

The debate about the extent to which countries should control the flow of foreign goods and investments across their borders is as old as international trade itself. Governments continue to control trade. To better understand how and why, let's examine a hypothetical case. Suppose you're in charge of a small country in which people do two things—grow food and make clothes. Because the quality of both products is high and the prices are reasonable, your consumers are happy to buy locally made food and clothes. But one day, a farmer from a nearby country crosses your border with several wagonloads of wheat to sell. On the same day, a foreign clothes maker arrives with a large shipment of clothes. These two entrepreneurs want to sell food and clothes in your country at prices below those that local consumers now pay for domestically made food and clothes. At first, this seems like a good deal for your consumers: they won't have to pay as much for food and clothes. But then you remember all the people in your country who grow food and make clothes. If no one buys their goods (because the imported goods are cheaper), what will happen to their livelihoods? Will everybody be out of work? And if everyone's unemployed, what will happen to your national economy?

That's when you decide to protect your farmers and clothes makers by setting up trade rules. Maybe you'll increase the prices of imported goods by adding a tax to them; you might even make the tax so high that they're more expensive than your homemade goods. Or perhaps you'll help your farmers grow food more cheaply by giving them financial help to defray their costs. The government payments that you give to the farmers to help offset some of their costs of production are called subsidies. These subsidies will allow the farmers to lower the price of their goods to a point below that of imported competitors' goods. What's even better is that the lower costs will allow the farmers to export their own goods at attractive, competitive prices.

The United States has a long history of subsidizing farmers. Subsidy programs guarantee farmers (including large corporate farms) a certain price for their crops, regardless of the market price. This guarantee ensures stable income in the farming community but can have a negative impact on the world economy. How? Critics argue that in allowing American farmers to export crops at artificially low prices, U.S. agricultural subsidies permit them to compete unfairly with farmers in developing countries. A reverse situation occurs in the steel industry, in which a number of countries—China, Japan, Russia, Germany, and Brazil—subsidize domestic producers. U.S. trade unions charge that this practice gives an unfair advantage to foreign producers and hurts the American steel industry, which can't compete on price with subsidized imports.

Whether they push up the price of imports or push down the price of local goods, such initiatives will help locally produced goods compete more favorably with foreign goods. Both strategies are forms of trade controls—policies that restrict free trade. Because they protect domestic industries by reducing foreign competition, the use of such controls is often called protectionism. Though there's considerable debate over the pros and cons of this practice, all countries engage in it to some extent. Before debating the issue, however, let's learn about the more common types of trade restrictions: tariffs, quotas, and, embargoes.

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3.5: Reducing International Trade Barriers

Learning Objective

1. Discuss the various initiatives designed to reduce international trade barriers and promote free trade.

A number of organizations work to ease barriers to trade, and more countries are joining together to promote trade and mutual economic benefits. Let's look at some of these important initiatives.

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3.6: Preparing for a Career in International Business

Learning Objective

1. Understand how to prepare for a career in international business.

No matter where your career takes you, you won't be able to avoid the reality and reach of international business. We're all involved in it. Some readers may want to venture more seriously into this exciting arena. The career opportunities are exciting and challenging, but taking the best advantage of them requires some early planning. Here are some hints.

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3.7: Cases and Problems

Learning on the Web (AACSB)

Keeping Current About Currency

On a day-to-day basis, you probably don't think about what the U.S. dollar (US\$) is worth relative to other currencies. But there will likely be times when ups and downs in exchange rates will seem extremely important to you in your business career. The following are some hypothetical scenarios that illustrate what these times may be. (Note: To respond to the questions raised in each scenario, search Google for a currency converter.)

Scenario 1: Your Swiss Vacation

Your family came from Switzerland, and you and your parents visited relatives there back in 2007. Now that you're in college, you want to make the trip on your own during spring break. While you're there, you also plan to travel around and see a little more of the country. You remember that in 2007, US\$1 bought 1.22 Swiss francs (Fr). You estimate that, at this rate, you can finance your trip (excluding airfare) with the \$1,200 that you earned this summer. You've heard, however, that the exchange rate has changed. Given the current exchange rate, about how much do you think your trip would cost you? As a U.S. traveler going abroad, how are you helped by a shift in exchange rates? How are you hurt?

Scenario 2: Your British Friends

A few years ago, you met some British students who were visiting the United States. This year, you're encouraging them to visit again so that you can show them around New York City. When you and your friends first talked about the cost of the trip back in 2007, the British pound (£) could be converted into US\$1.90. You estimated that each of your British friends would need to save up about £600 to make the trip (again, excluding plane fare). Given today's exchange rate, how much will each person need to make the trip? Have your plans been helped or hindered by the change in exchange rates? Was the shift a plus for the U.S. travel industry? What sort of exchange-rate shift hurts the industry?

Scenario 3: Your German Soccer Boots

Your father rarely throws anything away, and while cleaning out the attic a few years ago, he came across a pair of vintage Adidas soccer boots made in 1955. Realizing that they'd be extremely valuable to collectors in Adidas's home country of Germany, he hoped to sell them for US \$5,000 and, to account for the exchange rate at the time, planned to price them at \$7,200 in euros. Somehow, he never got around to selling the boots and has asked if you could sell them for him on eBay. If he still wants to end up with US \$5,000, what price in euros will you now have to set? Would an American company that exports goods to the European Union view the current rate more favorably or less favorably than it did back in 2007?

Career Opportunities (AACSB)

Broadening Your Business Horizons

At some point in your life, you'll probably meet and work with people from various countries and cultures. Participating in a college study-abroad program can help you prepare to work in the global business environment, and now is as good a time as any to start exploring this option. Here's one way to go about it:

- Select a study-abroad program that interests you. To do this, you need to decide what country you want to study in and your academic field of interest. Unless you speak the language of your preferred country, you should pick a program offered in English.
 - If your school offers study-abroad programs, choose one that has been approved by your institution.
 - If your school doesn't offer study-abroad programs, locate one through a Web search.
- Describe the program, the school that's offering it, and the country to which it will take you.
- Indicate why you've selected this particular program, and explain how it will help you prepare for your future business career.

Ethics Angle (AACSB)

The Right, Wrong, and Wisdom of Dumping and Subsidizing

When companies sell exported goods below the price they'd charge in their home markets (and often below the cost of producing the goods), they're engaging in *dumping*. When governments guarantee farmers certain prices for crops regardless of market prices,

the beneficiaries are being *subsidized*. What do you think about these practices? Is dumping an unfair business practice? Why, or why not? Does subsidizing farmers make economic sense for the United States? What are the effects of farm subsidies on the world economy? Are the ethical issues raised by the two practices comparable? Why, or why not?

Team-Building Skills (AACSB)

Three Little Words: The China Price

According to business journalists Pete Engardio and Dexter Roberts, the scariest three words that a U.S. manufacturer can hear these days are *the China price*. To understand why, go to the *Business Week* Web site (<http://www.businessweek.com/magazine...9/b3911401.htm>) and read its article “The China Price,” which discusses the benefits and costs of China’s business expansion for U.S. companies, workers, and consumers. Once you’ve read the article, each member of the team should be able to explain the paradoxical effect of U.S.–Chinese business relationships—namely, that they can hurt American companies and workers while helping American companies and consumers.

Next, your team should get together and draw up two lists: a list of the top five positive outcomes and a list of the top five negative outcomes of recent Chinese business expansion for U.S. businesses, workers, and consumers. Then, the team should debate the pros and cons of China’s emergence as a global business competitor and, finally, write a group report that answers the following questions:

1. Considered on balance, has China’s business expansion helped or harmed U.S. companies, workers, and consumers? Justify your answers.
2. What will happen to U.S. companies, workers, and consumers in the future if China continues to grow as a global business competitor?
3. How should U.S. companies respond to the threats posed by Chinese competitors in their markets?
4. What can you do as a student to prepare yourself to compete in an ever-changing global business environment?

When you hand in your report, be sure to attach all the following items:

- Members’ individually prepared lists of ways in which business relationships with China both hurt and help U.S. businesses, workers, and consumers
- Your group-prepared list of the top five positive and negative effects of Chinese business expansion on U.S. businesses, workers, and consumers

The Global View (AACSB)

Go East, Young Job Seeker

How brave are you when it comes to employment? Are you bold enough to go halfway around the world to find work? Instead of complaining about U.S. jobs going overseas, you could take the bull by the horns and grab one job back. It’s not that tough to do, and it could be a life-changing experience. U.S. college graduates with business or technical backgrounds are highly sought after by companies that operate in India. If you qualify (and if you’re willing to relocate), you could find yourself working in Bangalore or New Delhi for some multinational company like Intel, Citibank, or GlaxoSmithKline (a pharmaceutical company). In addition, learning how to live and work in a foreign country can build self-confidence and make you more attractive to future employers. To get a glimpse of what it would be like to live and work in India, go to the Web sites of *American Way* magazine (<http://www.americanwaymag.com/jeffre...e-leela-palace>) and CNN and Money (http://money.cnn.com/2004/03/09/pf/workers_to_india), and check out the posted articles: “Passage to India,” and “Needs Job, Moves to India.” Then, go to the Monster Work Abroad Web site (<http://jobsearch.monsterindia.com/re...gin/index.html>) and find a job in India that you’d like to have, either right after graduation or about five years into your career. (When selecting the job, ignore its actual location and proceed as if it’s in Bangalore.) After you’ve pondered the possibility of living and working in India, answer the following questions:

1. What would your job entail?
2. What would living and working in Bangalore be like? What aspects would you enjoy? Which would you dislike?
3. What challenges would you face as an expatriate (a person who lives outside his or her native country)? What opportunities would you have?
4. How would the experience of working in India help your future career?
5. Would you be willing to take a job in India for a year or two? Why, or why not?

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CHAPTER OVERVIEW

4: Selecting a Form of Business Ownership

- 4.1: Factors to Consider
- 4.2: Sole Proprietorship
- 4.3: Partnership
- 4.4: Corporation
- 4.5: Other Types of Business Ownership
- 4.6: Mergers and Acquisitions
- 4.7: Cases and Problems

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4.1: Factors to Consider

Learning Objective

1. Identify the questions to ask in choosing the appropriate form of ownership for a business.

If you're starting a new business, you have to decide which legal form of ownership is best for you and your business. Do you want to own the business yourself and operate as a sole proprietorship? Or, do you want to share ownership, operating as a partnership or a corporation? Before we discuss the pros and cons of these three types of ownership—sole proprietorship, partnership, and corporation—let's address some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business.

1. What are you willing to do to set up and operate your business? Do you want to minimize the costs of getting started? Do you hope to avoid complex government regulations and reporting requirements?
2. How much control would you like? Do you want to own the company yourself, or do you want to share ownership with other people? Are you willing to share responsibility for running the business?
3. Do you want to be the sole benefactor of your efforts or are you willing to share profits with other people? Do you want to be in charge of deciding how much of the company's profits will be retained in the business?
4. Do you want to avoid special taxes? Do you want to avoid paying "business" income taxes on your business and then paying "personal" income taxes on profits earned by the business?
5. Do you have all the skills needed to run the business? Do you possess the talent and skills to run the business yourself, or would the business benefit from a diverse group of owners? Are you likely to get along with co-owners over an extended period of time?
6. Should it be possible for the business to continue without you? Is it important to you that the business survive you? Do you want to know that other owners can take over if you die or become disabled? Do you want to make it easy for ownership to change hands?
7. What are your financing needs? How do you plan to finance your company? Will you need a lot of money to start, operate, and grow your business? Can you furnish the money yourself, or will you need some investment from other people? Will you need bank loans? If so, will you have difficulty getting them yourself?
8. How much liability exposure are you willing to accept? Are you willing to risk your personal assets—your bank account, your car, maybe even your home—for your business? Are you prepared to pay business debts out of your personal funds? Do you feel uneasy about accepting personal liability for the actions of fellow owners?

No single form of ownership will give you everything you desire. You'll have to make some trade-offs. Because each option has both advantages and disadvantages, your job is to decide which one offers the features that are most important to you. In the following sections we'll compare the three ownership options (sole proprietorship, partnership, corporation) on the eight dimensions that we identified previously: setup costs and government regulations control, profit sharing, income taxes, skills, continuity and transferability, ability to obtain financing, and liability exposure.

Key Takeaways

- Some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business include the following:
 1. *What are you willing to do to set up and operate your business?*
 2. *How much control do you want?*
 3. *Do you want to share profits with others?*
 4. *Do you want to avoid special taxes on your business?*
 5. *Do you have all the skills needed to run the business?*
 6. *Should it be possible for the business to continue without you?*
 7. *What are your financing needs?*
 8. *How much liability exposure are you willing to accept?*
- No single form of ownership—sole proprietorship, partnership, or corporation—will give you everything you want. Each has advantages and disadvantages.

Exercise

(AACSB) Analysis

Review the eight questions identified in this section that you'd probably ask yourself in choosing the appropriate legal form. Rate each of the questions using this scale: [1] not at all important; [2] not very important; [3] somewhat important; [4] very important; [5] extremely important. Select the two questions that are most important to you and the two questions that are least important to you, and explain your responses to these four questions.

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4.2: Sole Proprietorship

Learning Objective

1. Describe the sole proprietorship form of organization, and specify its advantages and disadvantages.

A sole proprietorship is a business owned by only one person. The most common form of ownership, it accounts for about 72 percent of all U.S. businesses (The National Data Book, 2011). It's the easiest and cheapest type of business to form: if you're using your own name as the name of your business, you just need a license to get started, and once you're in business, you're subject to few government regulations.

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4.3: Partnership

Learning Objectives

1. Identify the different types of partnerships, and explain the importance of a partnership agreement.
2. Describe the advantages and disadvantages of the partnership form of organization.

A partnership (or general partnership) is a business owned jointly by two or more people. About 10 percent of U.S. businesses are partnerships (The National Data Book, 2011), and though the vast majority are small, some are quite large. For example, the big four public accounting firms are partnerships. Setting up a partnership is more complex than setting up a sole proprietorship, but it's still relatively easy and inexpensive. The cost varies according to size and complexity. It's possible to form a simple partnership without the help of a lawyer or an accountant, though it's usually a good idea to get professional advice. Professionals can help you identify and resolve issues that may later create disputes among partners.

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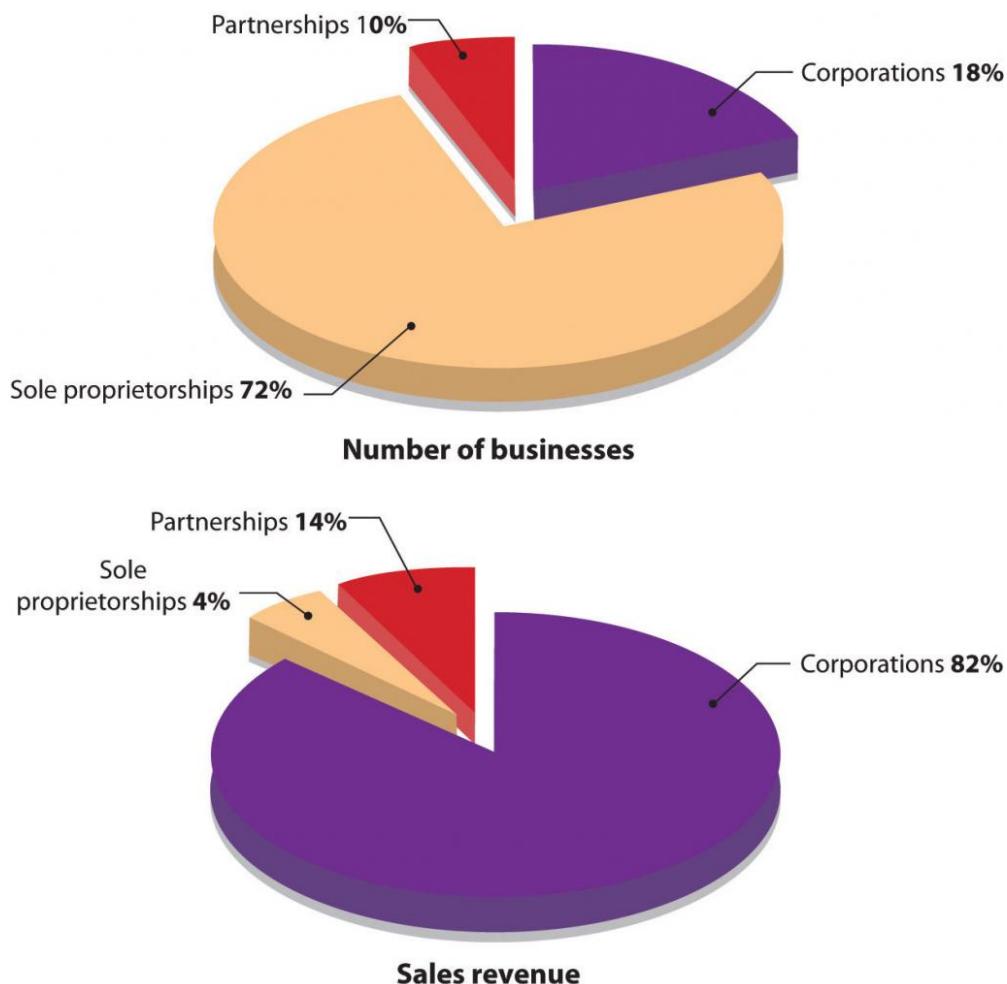
4.4: Corporation

Learning Objectives

1. Explain how corporations are formed and how they operate.
2. Discuss the advantages and disadvantages of the corporate form of ownership.

A corporation (sometimes called a *regular* or C-corporation) differs from a sole proprietorship and a partnership because it's a legal entity that is entirely separate from the parties who own it. It can enter into binding contracts, buy and sell property, sue and be sued, be held responsible for its actions, and be taxed. As Figure 4.5 "Types of U.S. Businesses" shows, corporations account for 18 percent of all U.S. businesses but generate almost 82 percent of the revenues (The National Data Book, 2011). Most large well-known businesses are corporations, but so are many of the smaller firms with which you do business.

Figure 4.5 Types of U.S. Businesses



Source: "Number of Tax Returns, Receipts, and Net Income by Type of Business," *The 2011 Statistical Abstract: The National Data Book*, www.census.gov/compendia/stat...porations.html (accessed August 27, 2011); "Number of Tax Returns and Business Receipts by Size of Receipts," *The 2011 Statistical Abstract: The National Data Book*, www.census.gov/compendia/stat...porations.html (accessed August 27, 2011).

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4.5: Other Types of Business Ownership

Learning Objective

1. Examine special types of business ownership, including S-corporations, limited-liability companies, cooperatives, and not-for-profit corporations.

In addition to the three commonly adopted forms of business organization—sole proprietorship, partnership, and regular corporations—some business owners select other forms of organization to meet their particular needs. We'll look at several of these options:

- S-corporations
- Limited-liability companies
- Cooperatives
- Not-for-profit corporations

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4.6: Mergers and Acquisitions

Learning Objective

1. Define mergers and acquisitions, and explain why companies are motivated to merge or acquire other companies.

The headline read, “Wanted: More than 2,000 in Google Hiring Spree” (Oreskovic, 2011; The Official Google Blog, 2011). The largest Web search engine in the world was disclosing its plans to grow internally and increase its workforce by more than 2,000 people, with half of the hires coming from the United States and the other half coming from other countries. The added employees will help the company expand into new markets and battle for global talent in the competitive Internet information providers industry. When properly executed, internal growth benefits the firm.

An alternative approach to growth is to merge with or acquire another company. The rationale behind growth through merger or acquisition is that $1 + 1 = 3$: the combined company is more valuable than the sum of the two separate companies. This rationale is attractive to companies facing competitive pressures. To grab a bigger share of the market and improve profitability, companies will want to become more cost efficient by combining with other companies.

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4.7: Cases and Problems

Learning on the Web (AACSB)

Do you have an idea for a charitable organization you'd like to start? Think of some cause that's important to you. Then go online and review this article by Joanne Fritz, "How to Incorporate as a Nonprofit: A Check List" located at <http://nonprofit.about.com/od/nonprofitbasics/ht/startingssteps.htm>. Draft a mission statement for your not-for-profit organization, and indicate the types of people you'd ask to serve on your board of directors. Then list the steps you'd take to set up your not-for-profit organization.

Career Opportunities

Where Do You Find Happiness?

Have you given much thought to whether you'd be happier working for a small company or for a big one? Here's your chance to compare and contrast the opportunities that small companies and big companies offer. First, read the article "Company Research—Investigate Small Companies" (<http://jobsearch.about.com/cs/employerresearch/a/compresearch.htm>). Then read the article "Benefits of Working in a Small Company vs. a Corporation" (http://www.streetdirectory.com/travel_guide/190820/careers_and_job_hunting/benefits_of_working_in_a_small_company_vs_a_corporation.html) (Doyle, 2011; Jacowsk, 2011). Identify five advantages of working for a small company and five advantages of working for a big one. Indicate your choice of employer (small or big company), and explain why you selected this option.

Ethics Angle (AACSB)

Bermuda Is Beautiful, but Should You Incorporate There?

A company can incorporate in any state it chooses. Most small businesses incorporate in the state in which they do business, while larger companies typically hunt around for the state or country that gives them the most favorable treatment (lower taxes, fewer restrictions). A growing number of U.S. companies are incorporating in Bermuda to lower their corporate income taxes while still enjoying the benefits of doing business in the United States. Does this seem right to you? Read these two articles and answer the questions that follow:

- "U.S. Corporations Are Using Bermuda to Slash Tax Bills," by David Cay Johnston, New York Times on the Web, February 18, 2002, <http://query.nytimes.com/gst/fullpage.html?res=9901EEDB1E3FF93BA25751C0A9649C8B63>
- "The Hidden Perils of Offshore Tax Havens," by Diane Brady, *BusinessWeek*, August 8, 2002, http://www.businessweek.com/bwdaily/..02088_953.htm

Questions:

- What advantages do U.S. companies gain by incorporating in Bermuda?
- What disadvantages do U.S. companies incur by incorporating in Bermuda?
- Do you find the practice of incorporating in Bermuda unethical? Why, or why not?

Team-Building Skills (AACSB)

Legally Speaking

Here's the scenario: You and your team serve as consultants to business owners who need help in deciding which legal form of ownership is best for them. You're currently working with three clients. For each client, you'll evaluate possible legal forms of organization, debate the alternatives, and make a recommendation. Then, you'll write a report to your client, presenting your recommendation and explaining why you arrived at your conclusion.

In addition to learning the basic facts about each company, you've gathered additional information by asking each client the following questions:

- How much control do you want?
- Do you want to share profits with others?
- How much liability exposure are you willing to accept?
- What are your financing needs?
- What are you willing to do to set up and operate your business?

- Should it be possible for the business to continue without you?

The following is the information that you've collected about each client, along with ownership options you should consider.

Client 1: Rainforest Adventures

Rainforest Adventures offers one-day and multiday tours of several locations in Australia. It works both with tourists and with study groups, and its clientele varies from people who want a relaxing experience away from hectic urban life to those who are keenly interested in the exotic environment. The business is dedicated to the preservation of Australia's tropical and wetland preserves. Its guides have many years of experience leading tourists through the rainforests, particularly at night when they come alive.

Rainforest Adventures was started three years ago by Courtney Kennedy, who has fifteen years of experience in the ecotourism industry. She runs the business as a sole proprietorship but is considering a partnership. (She doesn't want the cost or hassle of doing business as a corporation.) In questioning her, you found out the following: Kennedy is dedicated to preserving the Australian wetlands and sees her business as a way of encouraging people to support conservation efforts. However, her guides have displayed an "it's just-a-job" attitude, have become increasingly undependable, and are unwilling to share her commitment. Still, Kennedy has several trusted friends who not only have years of experience as guides, but who also share her enthusiasm for environmental preservation. She's optimistic that they'd be willing to join her in the business. She dreams of expanding her business to offer classes on the ecology of the rainforest but doesn't have enough cash, and she's afraid that a loan application will be turned down by the bank.

Options

Because Kennedy doesn't want to incorporate, she's left with two options: to continue doing business as a sole proprietorship or to find one or more individuals to join her in a partnership. After evaluating these two alternatives, you should recommend the one that you consider most appropriate. You should discuss the pros and cons of both options and explain how each applies to Kennedy's situation. If you recommend forming a partnership, you need to distinguish between a general partnership and a limited partnership, as well as explain what a partnership agreement is, what it covers, and why it's important.

Client 2: Scuffy the Tugboat

Scuffy the Tugboat is a family-run business that makes tugboats. It was formed as a partnership in 1996 by the three McLaughlin brothers—Mick (a naval architect), Jack (an accountant), and Bob (a marine engineer). Their first tugboat is still towing ships in Boston harbor, and over the years, success has allowed them to grow the company by plowing money back into it. Last year's sales were more than \$7 million. Now, however, they want to double production by expanding their factory by five thousand square feet. They estimate a cost of about \$1 million, yet a bigger facility would enable them to avoid late-delivery penalties that can run up to \$2,000 a day. They're not sure, however, about the best way to raise the needed funds. None of the brothers has \$1 million on hand, and because lenders are often hesitant to loan money to shipbuilders, even those with good performance records, local banks haven't been encouraging.

Unlike many partners, the three brothers get along quite well. They're concerned, though, about the risks of taking on personal debts for the business. In particular, they don't like being liable not only for their own actions, but also for the actions of all the partners.

Options

You should recommend that Scuffy the Tugboat either remain a partnership or become a privately-held corporation. State the pros and cons of both forms of organization, and explain how they apply to the brothers' situation.

Client 3: Dinner Rendezvous

For three years, owner Peggy Deardon has been operating Dinner Rendezvous, which gives individuals an opportunity to meet others and expand their social networks, in Austin, Texas. Interested clients go to the company's Web site and fill out applications and privacy statements. There's an annual membership fee of \$125 and a \$15 charge for each dinner attended (plus the cost of dinner and drinks). Deardon sets up all dinners and is onsite at the restaurant to introduce guests and serve complimentary champagne. While the company has a steady clientele, it's not a big moneymaker. If Deardon didn't have a regular full-time job, she couldn't keep the business running. She stays with it because she enjoys it and believes that she provides a good service for Austin residents. Because it's run out of her home, and because her biggest cost is the champagne, it's a low-risk business with no debts. With a full-time job, she also appreciates the fact that it requires only a few hours of her time each week.

Options

Since your client wants advice on whether to incorporate, you should evaluate two options—remaining a sole proprietorship or forming a corporation. In addition to your recommendation, you should state the pros and cons of both forms of organization and explain how they apply to Deardon's situation.

The Global View (AACSB)

America for Sale

Our U.S. companies continue to expand by merging with or acquiring other companies. This is acceptable business practice. But what happens when our U.S. companies and other assets are bought up by firms and individuals outside the United States? Is this acceptable business practice or something we should be concerned about? Learn how this is happening by reading this article by Geoff Colvin:

- “America for Sale,” *Fortune*, CNNMoney.com, February 6, 2008,
http://money.cnn.com/2008/01/30/news/economy/Colvin_recession.fortune/index.htm?postversion=2008020609

Questions:

- Why are foreigners buying U.S. assets?
- Is the current trend in foreign investments in U.S. assets positive or negative for the United States? Whom does it help? Whom does it hurt? Explain.
- What, if anything, can the United States do to stop this trend?
- If you were able, would you limit foreign investment in U.S. assets? Why, or why not?

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CHAPTER OVERVIEW

5: The Challenges of Starting a Business

- 5.1: What Is an Entrepreneur?
- 5.2: The Importance of Small Business to the U.S. Economy
- 5.3: What Industries Are Small Businesses In?
- 5.4: Advantages and Disadvantages of Business Ownership
- 5.5: Starting a Business
- 5.6: The Business Plan
- 5.7: How to Succeed in Managing a Business
- 5.8: Cases and Problems

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5.1: What Is an Entrepreneur?

Learning Objectives

1. Define *entrepreneur*.
2. Describe the three characteristics of entrepreneurial activity.
3. Identify five potential advantages to starting your own business.
4. Explain the differences among three types of start-up firms.

In developing BTIO and Realityworks Inc., the Jurmans were doing what entrepreneurs do (and doing it very well). In fact, Mary was nominated three times for the Ernst & Young Entrepreneur of the Year Award and named 2001 Wisconsin Entrepreneurial Woman of the Year by the National Association of Women Business Owners. So what, exactly, is an *entrepreneur*? What does an entrepreneur do? According to one definition, an entrepreneur is an “individual who starts a new business,” and that’s true as far as it goes. Another definition identifies an entrepreneur as someone who uses “resources to implement innovative ideas for new, thoughtfully planned ventures,” (Canadian Foundation for Economic Education, 2008) which is also true as far as it goes. But an important component of a satisfactory definition is still missing. To appreciate fully what it is, let’s go back to the story of the Jurmans, for whom entrepreneurship seems to have worked out quite well. We hasten to point out that, in 1993, the Jurmans were both unemployed—Rick had been laid off by General Dynamics Corp., and Mary by the San Diego Gas and Electric Company. While they were watching the show about teenagers and flour sacks, they were living off a loan from her father and the returns from a timely investment in coffee futures. Rick recalls that the idea for a method of creating BTIO came to him while “I was awake in bed, worrying about being unemployed.” He was struggling to find a way to feed his family. He had to make the first forty simulators himself, and at the end of the first summer, BTIO had received about four hundred orders—a promising start, perhaps, but, at \$250 per baby (less expenses), not exactly a windfall. “We were always about one month away from bankruptcy,” recalls Mary.

At the same time, it’s not as if the Jurmans started up BTIO simply because they had no “conventional” options for improving their financial prospects. Rick, as we’ve seen, was an aerospace engineer, and his résumé includes work on space-shuttle missions at NASA. Mary, who has not only a head for business but also a degree in industrial engineering, has worked at the Johnson Space Center. Therefore, the idea of replacing a sack of flour with a computer-controlled simulator wasn’t necessarily rocket science for the couple. But taking advantage of that idea—choosing to start a new business and to commit themselves to running it—was a risk. *Risk taking* is the missing component that we’re looking for in a definition of *entrepreneurship*, and so we’ll define an entrepreneur as someone who identifies a business opportunity and assumes *the risk of creating and running a business* to take advantage of it.

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5.2: The Importance of Small Business to the U.S. Economy

Learning Objectives

1. Define a *small business*.
2. Explain the importance of small businesses to the U.S. economy.
3. Explain why small businesses tend to foster innovation more effectively than large ones.
4. Describe some of the ways in which small companies work with big ones.

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5.3: What Industries Are Small Businesses In?

Learning Objectives

1. Describe the *goods-producing* and *service-producing* sectors of an economy.
2. Identify the industries in which small businesses are concentrated.

If you want to start a new business, you probably should avoid certain types of businesses. You'd have a hard time, for example, setting up a new company to make automobiles or aluminum, because you'd have to make tremendous investments in property, plant, and equipment, and raise an enormous amount of capital to pay your workforce.

Fortunately, plenty of opportunities are still available if you're willing to set your sights a little lower. Many types of businesses require reasonable initial investments, and not surprisingly, these are the ones that usually present attractive small business opportunities.

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5.4: Advantages and Disadvantages of Business Ownership

Learning Objective

1. Summarize the advantages and disadvantages of business ownership.

Do you want to be a business owner someday? Before deciding, you might want to consider the following advantages and disadvantages of business ownership (Small Business Development Center, 2006).

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5.5: Starting a Business

Learning Objectives

1. Explain what it takes to start a business.
2. Evaluate the advantages and disadvantages of several small business ownership options—starting a business from scratch, buying an existing business, and obtaining a franchise.

Starting a business takes talent, determination, hard work, and persistence. It also requires a lot of research and planning. Before starting your business, you should appraise your strengths and weaknesses and assess your personal goals to determine whether business ownership is for you (Allen, 2001).

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5.6: The Business Plan

Learning Objective

1. Discuss the importance of planning for your business, and identify the key sections of a business plan.

If you want to start a business, you must prepare a business plan. This essential document should tell the story of your business concept, provide an overview of the industry in which you will operate, describe the goods or services you will provide, identify your customers and proposed marketing activities, explain the qualifications of your management team, and state your projected income and borrowing needs.

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5.7: How to Succeed in Managing a Business

Learning Objectives

1. Discuss ways to succeed in managing a business, and explain why some businesses fail.
2. Identify sources of small business assistance from the Small Business Administration.

Why Do Businesses Succeed?

Being successful as a business owner requires more than coming up with a brilliant idea and working hard. You need to learn how to manage and grow your business. In the process, you'll face numerous challenges, and your ability to meet them will be a major factor in your success (or failure) (D&B, 2008). To give yourself a fighting chance in making a success of your business, you should do the following:

- *Know your business.* It seems obvious, but it's worth mentioning: successful businesspeople know what they're doing. They're knowledgeable about the industry in which they operate (both as it stands today and where it's headed), and they know who their competitors are. They know how to attract customers and who the best suppliers and distributors are, and they understand the impact of technology on their business.
- *Know the basics of business management.* You might be able to *start* a business on the basis of a great idea, but to *manage* it you need to understand the functional areas of business—accounting, finance, management, marketing, and production. You need to be a salesperson, as well as a decision maker and a planner.
- *Have the proper attitude.* When you own a business, you *are* the business. If you're going to devote the time and energy needed to transform an idea into a successful venture, you need to have a passion for your work. You should believe in what you're doing and make a strong personal commitment to your business.
- *Get adequate funding.* It takes a lot of money to start a business and guide it through the start-up phase (which can last for over a year). You can have the most brilliant idea in the world, the best marketing approach, and a talented management team, yet if you run out of cash, your career as a business owner could be brief. Plan for the long term and work with lenders and investors to ensure that you'll have sufficient funds to get open, stay open during the start-up phase, and, ultimately, expand.
- *Manage your money effectively.* You'll be under constant pressure to come up with the money to meet payroll and pay your other bills. That's why you need to keep an eye on *cash flow*—money coming in and money going out. You need to control costs and collect money that's owed you, and, generally, you need to know how to gather the financial information that you require to run your business.
- *Manage your time efficiently.* A new business owner can expect to work sixty hours a week. If you want to grow a business and have some type of nonwork life at the same time, you'll have to give up some control—to let others take over some of the work. Thus, you must develop time-management skills and learn how to delegate responsibility.
- *Know how to manage people.* Hiring, keeping, and managing good people are crucial to business success. As your business grows, you'll depend more on your employees. You need to develop a positive working relationship with them, train them properly, and motivate them to provide quality goods or services.
- *Satisfy your customers.* You might attract customers through impressive advertising campaigns, but you'll keep them only by providing quality goods or services. Commit yourself to satisfying—or even exceeding—customer needs.
- *Know how to compete.* Find your niche in the marketplace, keep an eye on your competitors, and be prepared to react to changes in the marketplace. The history of business (and much of life) can be summed up in three words: "Adapt or perish."

Why Do Businesses Fail?

If you've paid attention to the occupancy of shopping malls over a few years, you've noticed that retailers come and go with surprising frequency. The same thing happens with restaurants—indeed, with all kinds of businesses. By definition, starting a business—small or large—is risky, and though many businesses succeed, a large proportion of them don't. One-third of small businesses that have employees go out of business within the first two years. More than half of small businesses have closed by the end of their fourth year, and 70 percent do not make it past their seventh year (Knaup & Piazza, 2011; Knaup & Piazza, 2007).

Table 5.2 Survival Rate of New Companies

Number of Years after Start-up	Rate of Survival

Number of Years after Start-up	Rate of Survival
1	81.2%
2	65.8%
3	54.3%
4	44.4%
5	38.3%
6	34.4%
7	31.2%

Note: Percentages based on a total of 212,182 businesses that started up in the second quarter of 1998.

Source: “Characteristics of Survival: Longevity of Business Establishments in the Business Employment Dynamics Data: Extension.” www.bls.gov/osmr/pdf/st060040.pdf.

As bad as these statistics on business survival are, some industries are worse than others. If you want to stay in business for a long time, you might want to avoid some of these risky industries. Even though your friends think you make the best macaroni and cheese pizza in the world, this doesn’t mean you can succeed as a pizza parlor owner. Opening a restaurant or a bar is one of the riskiest ventures (and, therefore, start-up funding is hard to get). You might also want to avoid the transportation industry. Owning a taxi might appear lucrative until you find out what a taxi license costs. It obviously varies by city, but in New York City the price tag is upward of \$400,000. And setting up a shop to sell clothing can be challenging. Your view of “what’s in” may be off, and one bad season can kill your business. The same is true for stores selling communication devices: every mall has one or more cell phone stores so the competition is steep, and business can be very slow (Farrell, 2011).

Businesses fail for any number of reasons, but many experts agree that the vast majority of failures result from some combination of the following problems:

- *Bad business idea.* Like any idea, a business idea can be flawed, either in the conception or in the execution. If you tried selling snowblowers in Hawaii, you could count on little competition, but you’d still be doomed to failure.
- *Cash problems.* Too many new businesses are underfunded. The owner borrows enough money to set up the business but doesn’t have enough extra cash to operate during the start-up phase, when very little money is coming in but a lot is going out.
- *Managerial inexperience or incompetence.* Many new business owners have no experience in running a business; many have limited management skills. Maybe an owner knows how to make or market a product but doesn’t know how to manage people. Maybe an owner can’t attract and keep talented employees. Maybe an owner has poor leadership skills and isn’t willing to plan ahead.
- *Lack of customer focus.* A major advantage of a small business is the ability to provide special attention to customers. But some small businesses fail to seize this advantage. Perhaps the owner doesn’t anticipate customers’ needs or keep up with changing markets or the customer-focused practices of competitors.
- *Inability to handle growth.* You’d think that a sales increase would be a good thing. Often it is, of course, but sometimes it can be a major problem. When a company grows, the owner’s role changes. He or she needs to delegate work to others and build a business structure that can handle the increase in volume. Some owners don’t make the transition and find themselves overwhelmed. Things don’t get done, customers become unhappy, and expansion actually damages the company.

Help from the SBA

If you had your choice, which cupcake would you pick—vanilla Oreo, triple chocolate, or latte? In the last few years, cupcake shops are popping up in almost every city. Perhaps the bad economy has put people in the mood for small, relatively inexpensive treats. Whatever the reason, you’re fascinated with the idea of starting a cupcake shop. You have a perfect location, have decided what equipment you need, and have tested dozens of recipes (and eaten lots of cupcakes). You are set to go with one giant exception: you don’t have enough savings to cover your start-up costs. You have made the round of most local banks, but they are all unwilling to give you a loan. So what do you do? Fortunately, there is help available. It is through your local Small Business Administration (SBA), which offers an array of programs to help current and prospective small business owners. The SBA won’t

actually loan you the money, but it will increase the likelihood that you will get funding from a local bank by guaranteeing the loan. Here's how the SBA's loan guaranty program works: You apply to a bank for financing. A loan officer decides if the bank will loan you the money without an SBA guarantee. If the answer is no (because of some weakness in your application), the bank then decides if it will loan you the money if the SBA guarantees the loan. If the bank decides to do this, you get the money and make payments on the loan. If you default on the loan, the government reimburses the bank for its loss, up to the amount of the SBA guarantee.

In the process of talking with someone at the SBA, you will discover other programs it offers that will help you start your business and manage your organization. For example, to apply for funding you will need a well-written business plan. Once you get the loan and move to the business start-up phase, you will have lots of questions that need to be answered (including setting up a computer system for your company). And you are sure you will need help in a number of areas as you operate your cupcake shop. Fortunately, the SBA can help with all of these management and technical-service tasks.

This assistance is available through a number of channels, including the SBA's extensive Web site, online courses, and training programs. A full array of individualized services is also available. The Small Business Development Center (SBDC) assists current and prospective small business owners with business problems and provides free training and technical information on all aspects of small business management. These services are available at approximately one thousand locations around the country, many housed at colleges and universities (U.S. Small Business Administration, 2011).

If you need individualized advice from experienced executives, you can get it through the Service Corps of Retired Executives (SCORE). Under the SCORE program, a businessperson needing advice is matched with someone on a team of retired executives who work as volunteers. Together, the SBDC and SCORE help more than a million small businesspersons every year (U.S. Small Business Administration, 2011; SBDC Economic Impact, 2011).

Key Takeaways

- Business owners face numerous challenges, and the ability to meet them is a major factor in success (or failure). As a business owner, you should do the following:
 1. *Know your business.* Successful businesspeople are knowledgeable about the industry in which they operate, and they know who their competitors are.
 2. *Know the basics of business management.* To *manage* a business, you need to understand the functional areas of business—accounting, finance, management, marketing, and production.
 3. *Have the proper attitude.* You should believe in what you're doing and make a strong personal commitment to it.
 4. *Get adequate funding.* Plan for the long term and work with lenders and investors to ensure that you'll have sufficient funds to get open, stay open during the start-up phase, and, ultimately, expand.
 5. *Manage your money effectively.* You need to pay attention to *cash flow*—money coming in and money going out—and you need to know how to gather the financial information that you require to run your business.
 6. *Manage your time efficiently.* You must develop time-management skills and learn how to delegate responsibility.
 7. *Know how to manage people.* You need to develop a positive working relationship with your employees, train them properly, and motivate them to provide quality goods or services.
 8. *Satisfy your customers.* Commit yourself to satisfying—or even exceeding—customer needs.
 9. *Know how to compete.* Find your niche in the marketplace, keep an eye on your competitors, and be prepared to react to changes in your business environment.
- Businesses fail for any number of reasons, but many experts agree that the vast majority of failures result from some combination of the following problems:
 1. *Bad business idea.* Like any idea, a business idea can be flawed, either in the conception or in the execution.
 2. *Cash problems.* Too many new businesses are underfunded.
 3. *Managerial inexperience or incompetence.* Many new business owners have no experience in running a business, and many have limited management skills.
 4. *Lack of customer focus.* Some owners fail to make the most of a small business's advantage in providing special attention to customers.
 5. *Inability to handle growth.* When a company grows, some owners fail to delegate work or to build an organizational structure that can handle increases in volume.

- Services available to current and prospective small business owners from the SBA include assistance in developing a business plan, starting a business, obtaining financing, and managing an organization.
- The **SBDC (Small Business Development Centers)** matches businesspeople needing advice with teams of retired executives who work as volunteers through the SCORE program.

Exercise

(AACSB) Analysis

1. It's the same old story: you want to start a small business but don't have much money. Go to <http://entrepreneurs.about.com/cs/businessideas/a/10startupideas.htm> and read the article titled "Business Ideas on a Budget." Identify a few businesses that you can start for \$20 or less (that's right—\$20 or less). Select one of these business opportunities that interests you. Why did you select this business? Why does the idea interest you? What would you do to ensure that the business was a success? If you needed assistance starting up or operating your business, where could you find help, and what type of assistance would be available?
2. Why do some businesses succeed while others fail? Identify three factors that you believe to be the most critical to business success. Why did you select these factors? Identify three factors that you believe to be primarily responsible for business failures, and indicate why you selected these factors.

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5.8: Cases and Problems

Learning on the Web (AACSB)

Would You Like to Own a Sub Shop?

How would you like to own your own sandwich shop? You could start one on your own or buy one that's already in business, but an easier way might be buying a franchise from SUBWAY, the largest fast-food franchise in the world (even bigger than McDonald's). SUBWAY began in 1965 when seventeen-year-old Fred DeLuca opened a tiny sandwich shop in Bridgeport, Connecticut, hoping to put himself through college. As it turns out, his venture paid off in more ways than one. By 1974, DeLuca was franchising his business concept, and today, there are more than fifteen thousand SUBWAY franchisees in some seventy-five countries.

Go to www.subway.com to link to the SUBWAY Web site and learn more about franchise opportunities with the company. After reviewing the information provided on the company's Web site, answer the following questions:

1. What do you have to do to get a SUBWAY franchise?
2. How much would it cost to open a SUBWAY shop?
3. What training and support would you receive from SUBWAY?
4. What advantages do you see in buying a SUBWAY franchise rather than starting a business from scratch? What disadvantages do you see?

Career Opportunities

Do You Want to Be an Entrepreneur?

Want to learn what it's like to be an entrepreneur? To help you decide whether life as an entrepreneur might be for you, go to <http://entrepreneurs.about.com/od/interviews/null.htm>; then link to the "Interview with Entrepreneurs" section of the About.com Web site and review the entrepreneur interviews. Select two entrepreneurs who interest you, and for each, do the following:

1. Describe the company that he or she founded.
2. Explain the reasons why he or she became an entrepreneur.
3. Explain what qualities, background, or both, prepared the individual to start a business.

After reading the interviews with these two entrepreneurs, answer the following questions:

1. What aspects of being an entrepreneur are particularly rewarding?
2. What's the downside of being an entrepreneur?
3. What challenges do entrepreneurs face?
4. Is entrepreneurship for you? Why, or why not?

Ethics Angle (AACSB)

Term Papers for Sale

You and some fellow classmates are sitting around over pizza one night when someone comes up with an idea for a business. All of you have old term papers and essays lying around, and a couple of you know how to set up a Web page. What if you combine these two assets and start a business selling term papers over the Internet? Over time, you could collect or buy additional inventory from other students, and since some of you are good at research and others are good writers, you could even offer "student clients" the option of customized papers researched and written just for them. You figure that you can charge \$15 for an "off-the-rack" paper, and for customized jobs, \$10 per double-spaced page seems reasonable.

You all agree that the idea is promising, and you and a partner volunteer to put together a business plan. You have no difficulty with the section describing your proposed business: you know what your business will do, what products it will offer, who your customers will be, how your products will be sold, and where you'll be located. So far, so good.

Let's pause at this point to consider the following questions:

1. Does selling term papers over the Internet make business sense? Is it a good business idea?
2. Could the venture be profitable?

Let's continue and find out how the business plan proceeds.

Now you're ready to write your section on industry analysis and the first question you need to answer is, who are the players in the industry? To get some answers, you go online, log on to Google, and enter the search term "term papers for sale." Much to your surprise, up pop dozens of links to companies that have beaten you to market. The first company you investigate claims to have a quarter-million papers in stock, plus a team of graduate students on hand to write papers for anyone needing specialized work.

There's also a statement that says something like this: "Our term papers and essays are intended to help students write their own papers. They should be used for research purposes only. Students using our term papers and essays should write their own papers and cite our work."

You realize now that you're facing not only stiff competition but an issue that, so far, you and your partners have preferred to ignore: Is the business that you have in mind even ethical? It occurs to you that you could probably find the answer to this question in at least one of the 8,484 term papers on ethics available on your competitor's Web site, but you decide that it would be more efficient to give the question some thought on your own.

At this point, then, let's pause again to identify a couple of questions that you need to ask yourself as you prepare a report of your findings for your partners:

1. Is the sole purpose of running a business to make a profit, or do you need to be concerned about what your products will be used for? Explain your reasoning.
2. Do you need to consider the ethics of what other people do with your product? Explain your reasoning.

When you report on the problem that you've uncovered, your would-be partners are pretty discouraged, some by the prospect of competition and some by the nagging ethical issue. Just as you're about to dissolve the partnership, one person speaks up: "How about selling software that lets faculty search to see if students have plagiarized material on the Web?"

"Sorry," says someone else. "It's already out there. Two students at Berkeley have software that compares papers to a hundred million Web pages."

Team-Building Skills (AACSB)

Knowing how to be an effective team member is a vital lifetime skill. It will help you in your academic career, in the business world, and in nonwork activities as well. It takes time and effort to learn how to work in a team. Part of the challenge is learning how to adjust your behavior to the needs of the group. Another part is learning how to motivate members of a group. A well-functioning team allows members to combine knowledge and skills, and this reliance on diverse backgrounds and strengths often results in team decisions that are superior to those made by individuals working alone.

Are You a Team Player?

As a first step, you should do a self-assessment to evaluate whether you possess characteristics that will help you be a successful team member. You can do this by taking a "Team Player" quiz available at the Quintessential Careers Web site. Go to www.quintcareers.com/team_player_quiz.html to link to this quiz. You'll get feedback that helps you identify the characteristics you need to work on if you want to improve your teamwork skills.

Working Together as a Team

The best approach to specifying appropriate behavior for team members is for the team to come up with some ground rules. Get together with three other students selected by your instructor, and establish working guidelines for your team. Prepare a team report in which you identify the following:

1. Five things that team members can do to increase the likelihood of group success
2. Five things that team members can do to jeopardize group success

The Global View (AACSB)

Global Versions of MySpace

When Andrew Mason founded Groupon in November 2008, he had no idea that he was headed for an overnight success, but two years after he set out on his entrepreneurial adventure (which, admittedly, isn't actually overnight), Groupon had more than fifty million registered users and nine million customers who had purchased at least one "daily deal" (<http://www.digital-dd.com/wp-content/uploads/2011/06/groupon-ipo-s-1.pdf>).

What's ahead for Groupon? Can its business model be exported to even more locations outside the United States? If you were in charge of global expansion for Groupon, what country would you enter next? What country would you avoid? To identify promising and not-so-promising foreign markets, go to the Groupon Wikipedia article (<http://en.Wikipedia.org/wiki/Groupon>) and click on "Geographic Markets" to obtain a list of countries in which Groupon operates. Also go to http://news.bbc.co.uk/1/hi/country_profiles/default.stm to link to the Country Profiles Web site maintained by BBC News. Study the economic and political profiles of possible overseas locations, and answer the following questions:

1. Why do you think Groupon has been so successful in the United States? Cite some of the challenges that it still faces in this country.
2. If you were in charge of global expansion at Groupon, which country would you enter next? Why do you think the Groupon business concept will succeed in this country? What challenges will the company face there?
3. What country would you avoid? Why is it incompatible with the Groupon business concept?

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CHAPTER OVERVIEW

6: Managing for Business Success

[6.1: What Do Managers Do?](#)

[6.2: Planning](#)

[6.3: Organizing](#)

[6.4: Directing](#)

[6.5: Controlling](#)

[6.6: Managerial Skills](#)

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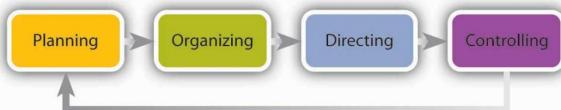
6.1: What Do Managers Do?

Learning Objective

1. Identify the four interrelated functions of management: planning, organizing, directing, and controlling.

You'll accomplish this task through management: the process of planning, organizing, directing, and controlling resources to achieve specific goals. A *plan* enables you to take your business concept beyond the idea stage. It does not, however, get the work *done*. You have to *organize* things if you want your plan to become a reality. You have to put people and other resources in place to make things happen. And because your note-taking venture is supposed to be better off with you in charge, you need to be a *leader* who can motivate your people to do well. Finally, to know whether things are in fact going well, you'll have to *control* your operations—that is, measure the results and compare them with the results that you laid out in your plan. Figure 6.1 “The Role of Planning” gives you a good idea of the interrelationship between planning and the other functions that managers perform.

Figure 6.1 The Role of Planning



Functions of Management

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6.2: Planning

Learning Objective

1. Understand the process by which a company develops and implements a strategic plan.

Without a plan, it's hard to succeed at anything. The reason is simple: if you don't know where you're going, you can't really move forward. Successful managers decide where they want to be and then figure out how to get there. In planning, managers set goals and determine the best way to achieve them. As a result of the planning process, everyone in the organization knows what should be done, who should do it, and how it should be done.

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6.3: Organizing

Learning Objective

1. Discuss various options for organizing a business, and create an organization chart.

Now that you've developed a strategic plan for Notes-4-You, you need to organize your company so that it can implement your plan. A manager engaged in organizing allocates *resources* (people, equipment, and money) to achieve a company's plans. Successful managers make sure that all the activities identified in the planning process are assigned to some person, department, or team and that everyone has the resources needed to perform assigned activities.

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6.4: Directing

Learning Objective

1. Explain how managers direct others and motivate them to achieve company goals.

The third management function is directing—providing focus and direction to others and motivating them to achieve organizational goals. As owner and president of Notes-4-You, you might think of yourself as an orchestra leader. You have given your musicians (employees) their sheet music (plans). You've placed them in sections (departments) and arranged the sections (organizational structure) so the music will sound as good as possible. Now your job is to tap your baton and lead the orchestra so that its members make beautiful music together (Reh, 2011).

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6.5: Controlling

Learning Objective

1. Describe the process by which a manager monitors operations and assesses performance.

Let's pause for a minute and reflect on the management functions that we've discussed so far—planning, organizing, and directing. As founder of Notes-4-You, you began by establishing plans for your new company. You defined its mission and set objectives, or performance targets, which you needed to meet in order to achieve your mission. Then, you organized your company by allocating the people and resources required to carry out your plans. Finally, you provided focus and direction to your employees and motivated them to achieve organizational objectives. Is your job finished? Can you take a well-earned vacation? Unfortunately, the answer is no: your work has just begun. Now that things are rolling along, you need to monitor your operations to see whether everything is going according to plan. If it's not, you'll need to take corrective action. This process of comparing actual to planned performance and taking necessary corrective action is called controlling.

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6.6: Managerial Skills

Learning Objective

1. Describe the skills needed to be a successful manager.

To be a successful manager, you'll have to master a number of skills. To get an entry-level position, you'll have to be technically competent at the tasks you're asked to perform. To advance, you'll need to develop strong interpersonal and conceptual skills. The relative importance of different skills varies from job to job and organization to organization, but to some extent, you'll need them all to forge a managerial career. Throughout your career, you'll also be expected to communicate ideas clearly, use your time efficiently, and reach sound decisions.

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6.7: Cases and Problems

Learning on the Web (AACSB)

Mission “Improvable”

A mission statement tells customers, employees, and stakeholders why the organization exists—its purpose. It can be concise, like the one from Mary Kay Cosmetics—“To enrich the lives of women around the world”—or it can be more detailed, such as the following from FedEx:

FedEx Corporation will produce superior financial returns for its shareowners by providing high value-added logistics, transportation and related business services through focused operating companies. Customer requirements will be met in the highest quality manner appropriate to each market segment served. FedEx will strive to develop mutually rewarding relationships with its employees, partners and suppliers. Safety will be the first consideration in all operations. Corporate activities will be conducted to the highest ethical and professional standards.

Mission statements are typically constructed to communicate several pieces of information: what the company strives to accomplish, what it's known for, and how it serves its customers. Here are a few examples:

- The Hershey Company: Bringing sweet moments of Hershey happiness to the world every day.
- Microsoft: Our Mission At Microsoft, we work to help people and businesses throughout the world realize their full potential. This is our mission. Everything we do reflects this mission and the values that make it possible.
- Google: Google's mission is to organize the world's information and make it universally accessible and useful.

Assignment

Create hypothetical mission statements for each of these four companies: Outback Steakhouse, Tesoro, Got Junk?, and Staples. To find descriptions of all four, go to the Web site for each of the companies: www.outbacksteakhouse.com, <http://www.tesorocorp.com>, http://www.1800gotjunk.com/us_en, www.staples.com.

In composing your four mission statements, follow the format suggested previously: each statement should be about two or three sentences long and should provide several pieces of information—what the company strives to accomplish, what it's known for, and how it serves its customers (and perhaps its employees and shareholders, too).

One last thing: *your statements should be originals, not duplicates of the companies' official statements.*

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CHAPTER OVERVIEW

7: Recruiting, Motivating, and Keeping Quality Employees

- 7.1: Human Resource Management
- 7.2: Developing Employees
- 7.3: Motivating Employees
- 7.4: What Makes a Great Place to Work?
- 7.5: Performance Appraisal
- 7.6: Labor Unions
- 7.7: Cases and Problems

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7.1: Human Resource Management

Learning Objective

1. Define *human resource management* and explain how managers develop and implement a human resource plan.

Employees at Starbucks are vital to the company's success. They are its public face, and every dollar of sales passes through their hands (Schultz & Yang, 1997). According to Howard Schultz, they can make or break the company. If a customer has a positive interaction with an employee, the customer will come back. If an encounter is negative, the customer is probably gone for good. That's why it's crucial for Starbucks to recruit and hire the right people, train them properly, motivate them to do their best, and encourage them to stay with the company. Thus, the company works to provide satisfying jobs, a positive work environment, appropriate work schedules, and fair compensation and benefits. These activities are part of Starbucks's strategy to deploy human resources in order to gain competitive advantage. The process is called human resource management (HRM), which consists of all actions that an organization takes to attract, develop, and retain quality employees. Each of these activities is complex. Attracting talented employees involves the recruitment of qualified candidates and the selection of those who best fit the organization's needs. Development encompasses both new-employee orientation and the training and development of current workers. Retaining good employees means motivating them to excel, appraising their performance, compensating them appropriately, and doing what's possible to retain them.

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7.2: Developing Employees

Learning Objective

1. Explain how companies train and develop employees, and discuss the importance of a diverse workforce.

Because companies can't survive unless employees do their jobs well, it makes economic sense to train them and develop their skills. This type of support begins when an individual enters the organization and continues as long as he or she stays there.

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7.3: Motivating Employees

Learning Objective

1. Define *motivation* and describe several theories of motivation.

Motivation refers to an internally generated drive to achieve a goal or follow a particular course of action. Highly motivated employees focus their efforts on achieving specific goals; those who are unmotivated don't. It's the manager's job, therefore, to motivate employees—to get them to try to do the best job they can. But what motivates employees to do well? How does a manager encourage employees to show up for work each day and do a good job? Paying them helps, but many other factors influence a person's desire (or lack of it) to excel in the workplace. What are these factors? Are they the same for everybody? Do they change over time? To address these questions, we'll examine four of the most influential theories of motivation: *hierarchy-of-needs theory*, *two-factor theory*, *expectancy theory*, and *equity theory*.

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7.4: What Makes a Great Place to Work?

Learning Objective

1. Identify factors that make an organization a good place to work, including competitive compensation and benefits packages.

Every year, the Great Places to Work Institute analyzes comments from thousands of employees and compiles a list of “The 100 Best Companies to Work for in America,” which is published in *Fortune* magazine. Having compiled its list for more than twenty years, the institute concludes that the defining characteristic of a great company to work for is trust between managers and employees. Employees overwhelmingly say that they want to work at a place where employees “trust the people they work for, have pride in what they do, and enjoy the people they work with” (Great Place to Work Institute, 2011). They report that they’re motivated to perform well because they’re challenged, respected, treated fairly, and appreciated. They take pride in what they do, are made to feel that they make a difference, and are given opportunities for advancement (Great Place to Work Institute, 2006). The most effective motivators, it would seem, are closely aligned with Maslow’s higher-level needs and Herzberg’s motivating factors.

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7.5: Performance Appraisal

Learning Objective

1. Explain how managers evaluate employee performance and retain qualified employees.

Employees generally want their managers to tell them three things: what they should be doing, how well they're doing it, and how they can improve their performance. Good managers address these issues on an ongoing basis. On a semiannual or annual basis, they also conduct formal performance appraisals to discuss and evaluate employees' work performance.

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7.6: Labor Unions

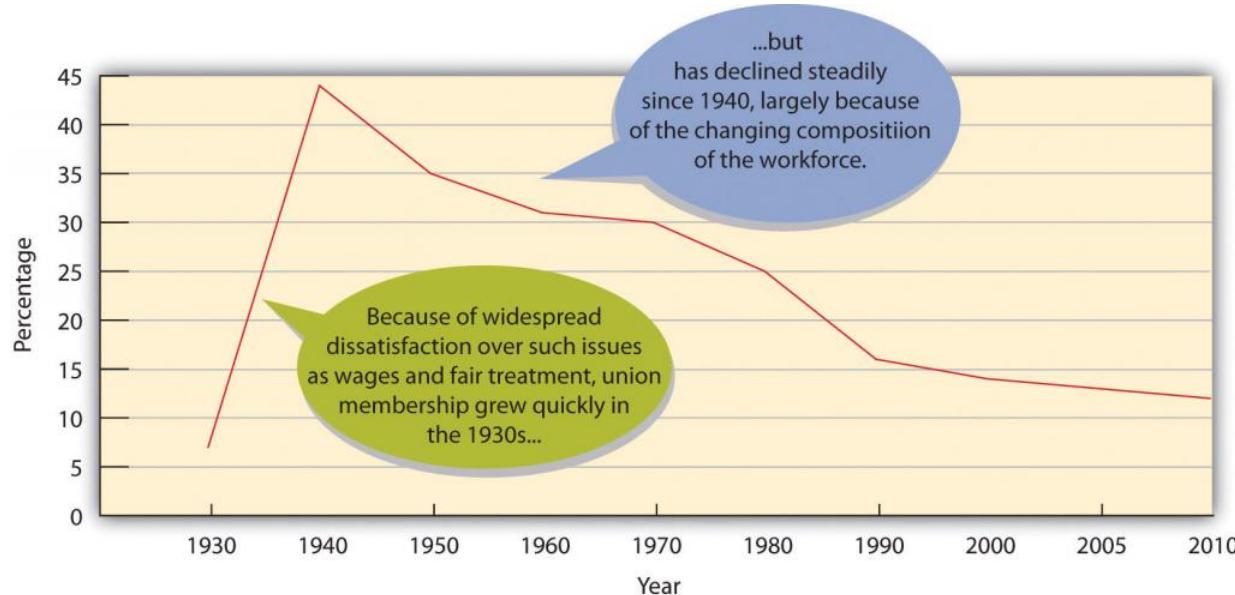
Learning Objective

1. Explain why workers unionize and how unions are structured, and describe the collective-bargaining process.

As we saw earlier, Maslow believed that individuals are motivated to satisfy five levels of unmet needs (physiological, safety, social, esteem, and self-actualization). From this perspective, employees should expect that full-time work will satisfy at least the two lowest-level needs: they should be paid wages that are sufficient for them to feed, house, and clothe themselves and their families, and they should have safe working conditions and some degree of job security. Organizations also have needs: they need to earn profits that will satisfy their owners. Sometimes, the needs of employees and employers are consistent: the organization can pay decent wages and provide workers with safe working conditions and job security while still making a satisfactory profit. At other times, there is a conflict—real, perceived, or a little bit of both—between the needs of employees and those of employers. In such cases, workers may be motivated to join a labor union—an organized group of workers that bargains with employers to improve its members' pay, job security, and working conditions.

Figure 7.10 “Labor Union Density, 1930–2010” charts *labor-union density*—union membership as a percentage of payrolls—in the United States from 1930 to 2010. As you can see, there’s been a steady decline since the mid-1950s, and, today, only about 12 percent of U.S. workers belong to unions (U.S. Department of Labor, 2011). Only membership among public workers (those employed by federal, state, and local governments, such as teachers, police, and firefighters) has grown. In the 1940s, 10 percent of public workers and 34 percent of those in the private sector belonged to unions. Today, this has reversed: 36 percent of public workers and 7 percent of those in the private sector are union members (Wikipedia, 2011).

Figure 7.10 Labor Union Density, 1930–2010



Why the decline in private sector unionization? Many factors come into play. The poor economy has reduced the number of workers who can become union members. In addition, we’ve shifted from a manufacturing-based economy characterized by large, historically unionized companies to a service-based economy made up of many small firms that are hard to unionize. Finally, there are more women in the workforce, and they’re more likely to work part-time or intermittently (Maher, 2010; Greenhouse, 2011).

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7.7: Cases and Problems

Learning on the Web (AACSB)

What's Your (Emotional) IQ?

If you were an HR manager, on what criteria would you base a hiring decision—intelligence (IQ), education, technical skills, experience, references, or performance on the interview? All these can be important determinants of a person's success, but some experts believe that there's an even better predictor of success. It's called *emotional intelligence* (or EI), and it gained some currency in the mid-1990s thanks to Daniel Goleman's book *Emotional Intelligence: Why It Can Matter More Than IQ*. EI is the ability to understand both our own emotions and those of others, as well as the ability to use that understanding in managing our behavior, motivating ourselves, and encouraging others to achieve goals.

An attractive aspect of EI is that, unlike IQ, it's not fixed at an early age. Rather, its vital components—self-awareness, self-management, social awareness, and relationship management—can be strengthened over time. To assess your level of EI, go to the Web site maintained by the Hay Group, a management-consulting firm, and take the ten-item test that's posted there (<http://psychology.about.com/library/...num=6&cor=2399>). After completing the test, you'll get your EI score, some instructions for interpreting it, and an answer key.

When you've finished with the test, rank the following items according to the importance that you'd give them in making a hiring decision: intelligence, education, technical skills, experience, references, interview skills, and emotional intelligence. Explain your ranking.

Career Opportunities

Are You a People Person?

You might not like the idea of sitting across the desk from a corporate college recruiter and asking for a job, but what if you were on the other side of the desk? As a recruiter, you'd get to return to campus each year to encourage students to join your company. Or, maybe you'd like to help your company develop a new compensation and benefits program, implement a performance-evaluation system, or create a new training program. All these activities fall under the umbrella of HR.

To learn more about the field of HR, go to the WetFeet Web site (wetfeet.com/Careers-and-Indus...obdescriptions) and read the page "Human Resources Overview." Then answer these questions:

1. What is the human resources field like?
2. What do HR professionals like about their jobs? What do they dislike?
3. Are job prospects in the HR field positive or negative? Which HR areas will experience the fastest growth?
4. Based on the job descriptions posted, which specific HR job would you want?

Finally, write a paragraph responding to this question: Do you find the HR field interesting? Why, or why not?

Ethics Angle (AACSB)

Misstating the Facts

Life couldn't get much better for George O'Leary when he was named the head football coach at Notre Dame. Unfortunately, he barely had time to celebrate his new job before he was ruled ineligible: after just a week on the job, he was forced to resign, embarrassing himself, his family, his friends, and Notre Dame itself. Why? Because of a few lies that he'd put on his résumé twenty years earlier. To get the facts behind this story, go to the *Sports Illustrated* Web site (sportsillustrated.cnn.com/foo...ry_notredame/) and read the article "Short Tenure: O'Leary Out at Notre Dame After One Week." Then, answer the following questions:

1. Was O'Leary's punishment appropriate? If you were the athletic director at Notre Dame, would you have meted out the same punishment? Why, or why not?
2. False information on his résumé came back to haunt O'Leary after twenty years. Once he'd falsified his résumé, was there any corrective action that he could have taken? If so, what?
3. If O'Leary had told Notre Dame about the falsifications before they came to light, would they have hired him?
4. Would his previous employer take him back?

5. O'Leary was later hired as a head coach by the University of Central Florida. Will the episode involving his résumé undermine his ability to encourage players to act with integrity? Will it affect his ability to recruit players?
6. What's the lesson to be learned from O'Leary's experience? In what ways might a few (theoretical) misstatements on your résumé come back to haunt you?

Team-Building Skills (AACSB)

Dorm Room Rescue

Any night of the week (at least as of this writing), you can relax in front of the TV and watch a steady stream of shows about how to improve your living space—such as *New Spaces*. You like the concept of these programs well enough, but you're tired of watching them in a tiny, cluttered dorm room that's decorated in early barracks style. Out of these cramped conditions, however, you and a team of friends come up with an idea. On graduation, you'll start a business called Dorm Room Rescue to provide decorating services to the dorm dwellers who come after you. You'll help college students pick colors and themes for their rooms and select space-saving furniture, storage materials, area rugs, and wall decorations. Your goal will be to create attractive dorm rooms that provide comfort, functionality, and privacy, as well as pleasant spaces in which students can relax and even entertain.

The team decides to develop a plan for the HR needs of your future company. You'll need to address the following issues:

1. Number of employees
2. Job descriptions: duties and responsibilities for each type of employee
3. Job specifications: needed skills, knowledge, and abilities
2. Recruitment of qualified employees
 - Recruitment plan: how and where to find candidates
 - Selection process: steps taken to select employees
3. Developing employees
 - New-employee orientation
 - Training and development
4. Compensation and benefits
 - Wages, salaries, and incentive programs
 - Benefits
5. Work/Life quality
 - Work schedules and alternative work arrangements
 - Family-friendly programs
6. Performance appraisal
 - Appraisal process
 - Retaining valuable employees

You might want to divide up the initial work, but you'll need to regroup as a team to make your final decisions on these issues and to create a team-prepared report.

The Global View (AACSB)

Sending Ed to China

You're the HR manager for a large environmental consulting firm that just started doing business in China. You've asked your top engineer, Ed Deardon, to relocate to Shanghai for a year. Though China will be new to Deardon, working overseas won't be; he's already completed assignments in the Philippines and Thailand; as before, his wife and three children will be going with him.

You've promised Deardon some advice on adapting to living and working conditions in Shanghai, and you intend to focus on the kinds of cultural differences that tend to create problems in international business dealings. Unfortunately, you personally know absolutely nothing about living in China and so must do some online research. Here are some promising sites:

- Executive Planet (www.executiveplanet.com/index.php?title=China)
- China Window (china-window.com)

- Los Angeles Chinese Learning Center (<http://chinese-school.netfirms.com>)

Instructions

Prepare a written report to Deardon in which you identify and explain five or six cultural differences between business behavior in the United States and China, and offer some advice on how to deal with them.

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CHAPTER OVERVIEW

8: Teamwork and Communications

[8.1: The Team and the Organization](#)

[8.2: Why Teamwork Works](#)

[8.3: The Team and Its Members](#)

[8.4: The Business of Communication](#)

[8.5: Communication Channels](#)

[8.6: Forms of Communication](#)

[8.7: Cases and Problems](#)

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8.1: The Team and the Organization

Learning Objectives

1. Define a *team* and describe its key characteristics.
2. Explain why organizations use teams, and describe different types of teams.

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8.2: Why Teamwork Works

Learning Objectives

1. Explain why teams may be effective or ineffective.
2. Identify factors that contribute to team cohesiveness.

Now that we know a little bit about *how* teams work, we need to ask ourselves *why* they work. Not surprisingly, this is a fairly complex issue. In this section, we'll answer these closely related questions: Why are teams often effective? Why are they sometimes *ineffective*?

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8.3: The Team and Its Members

Learning Objectives

1. Understand the importance of learning to participate in team-based activities.
2. Identify the skills needed by team members and the roles that members of a team might play.
3. Learn how to survive team projects in college (and actually enjoy yourself).
4. Explain the skills and behaviors that foster effective team leadership.

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8.4: The Business of Communication

Learning Objectives

1. Discuss the role of communication in the design of the RAZR cell phone.
2. Define *communication* and discuss the ways in which organizations benefit from effective communication.

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8.5: Communication Channels

Learning Objectives

1. Discuss the nature of communications in an organizational setting, including communication flows, channels, and networks.
2. Explain barriers to communication, and discuss the most common types of barriers to group communication.

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8.6: Forms of Communication

Learning Objectives

1. Explain the do's and don'ts of business e-mails.
2. Describe the process followed to create and deliver successful presentations.
3. Learn how to write clear, concise memos.

As mentioned previously, the College Board identified these communication skills as “frequently” or “almost always” necessary in the workplace (College Board, 2004): e-mail, presentation with visuals, technical reports, formal reports, memos, and presentations without visuals. The skill ranked highest in importance was the use of e-mails, including the ability to adapt messages to different receivers or compose persuasive messages when necessary. The ability to make presentations (with visuals) ranked second in importance. Report writing came next. Given the complexity of report writing, we will not cover this topic here. Instead, we will look at the remaining three forms of communication: e-mail, presentations with visuals, and memos.

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8.7: Cases and Problems

Learning on the Web (AACSB)

Factors Contributing to Nike's Success

This writing assignment solicits your opinion on factors contributing to Nike's success. To complete it, you should go to www.nikebiz.com/company_overview/timeline to learn about Nike's history by reviewing the company's time line.

Memo Format

Use the memo format described in the chapter for this assignment. Your memo should not exceed two pages. It should be single spaced (with an extra space between paragraphs and bulleted items).

Scenario

You're one of the fortunate college students selected to participate in Nike's summer internship program. The program is quite competitive, and you still can't believe that you were chosen. You arrived in Beaverton, Oregon, yesterday morning and have been busy ever since. Last night, you attended a dinner for new interns where you were welcomed to Nike by CEO Mark Parker.

You were lucky to be sitting next to a personable, well-informed Nike veteran named Simon Pestridge. Pestridge joined Nike about twelve years ago. He was telling you about a past assignment he had as director of marketing for Australia. (You were impressed with his status at Nike, not just because he doesn't look much older than you, but also because you've always wanted to travel to Australia.) The dinner conversation turned to a discussion of the reasons for Nike's success. Others at the table were giving their opinions on the subject when Pestridge turned to you and said, "As a new intern, give us an outsider's point of view. Why do you think Nike's been so successful?" You were about to venture an opinion when Pestridge was called away for a phone call. As he got up, however, he quickly said, "Send me a memo telling me what factors you think have contributed to Nike's success. Keep it simple. Three factors are plenty." Though you were relieved to have a little time to think about your answer, you were also a bit nervous about the prospect of writing your first official memo.

As everyone else headed for the Bo Jackson gym, you went back to your room to think about Pestridge's question and to figure out how to go about writing your memo. You want to be sure to start by telling him that you enjoyed talking with him. You also need to remind him that you're responding to his question about three factors in Nike's success, and must be sure to explain why you believe they're important. You'll end by saying that you hope the information is helpful and that he can contact you if he has any further questions.

So far, so good, but you're still faced with the toughest part of your task—identifying the three factors that you deem important to Nike's success. Fortunately, even at Nike there's always tomorrow to get something done, so you decide to sleep on it and write your memo in the morning.

Ethics Angle (AACSB)

The Goof-Off

You and three other students have been working on a group project all semester in your Introduction to Business class. One of the members of the team did very little work; he failed to attend almost all the meetings, took no responsibility for any of the tasks, didn't attend the practice session before your presentation, and in general was a real goof-off. But he happens to be friends with two of the team members. You and your other team members have been asked to complete the attached team member evaluation. You want to give the student what he deserves—almost no credit. But your other two team members don't agree. They argue that it is "unsocial and mean" to tell the truth about this student's lack of contribution. Instead, they want to report that everyone shared the work equally. The evaluation will be used in determining grades for each team member. Those who contributed more will get a higher grade than those who did not. Prepare an argument that you can advance to the other team members on the ethics of covering for this student. Assuming that your two teammates won't change their minds, what would you do?

Attachment to Ethics Angle Problem

Introduction to Business

Team Member Evaluation

(To be given to your faculty member during the last week of class)

TEAM _____

You have a total of \$100,000. You can use this to reward your team members (including yourself) for their contributions to the team project.

Fill in each team member's name below (including your own), and show beside each name how much of the \$100,000 you would give that member for his or her contributions to the preparation and presentation of the team project. Do not share your recommendations with your team members.

Your recommendations will be confidential.

Team Members (including yourself)	Amount to be given for efforts on team project
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
TOTAL (MUST EQUAL \$100,000)	\$ _____

YOUR NAME _____

Team-Building Skills (AACSB)

Team Skills and Talents

Team projects involve a number of tasks that are handled by individual team members. These tasks should be assigned to team members based on their particular skills and talents. The next time you work on a team project, you should use the following table to help your team organize its tasks and hold its members responsible for their completion.

Here is how you should use this document:

1. Identify all tasks to be completed.
2. Assign each task to a member (or members) of your team based on their skills, talents, and time available.
3. Determine a due date for each task.
4. As a task is completed, indicate its completion date and the team member (or members) who completed the task. If more than one team member works on the assignment, indicate the percentage of time each devoted to the task. You can add tasks that surface as your team works its way through the project.
5. If the assigned person fails to complete the task, or submits poor quality work, add a note to the report explaining what happened and how the situation was corrected (for example, another team member had to redo the task).
6. Submit the completed form (with all columns completed) to your faculty member at the class after your team project is due. Include a cover sheet with your team's name (or number) and the name of each team member.

Tasks to Be Completed	Initials of Team Member(s) Who Will Complete Task	Date to Be Completed	Date Completed	Initials of Team Member(s) Who Completed Task (Add a Note Below the Table Explaining Any Problems with Completion or Quality of Work)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Tasks to Be Completed	Initials of Team Member(s) Who Will Complete Task	Date to Be Completed	Date Completed	Initials of Team Member(s) Who Completed Task (Add a Note Below the Table Explaining Any Problems with Completion or Quality of Work)

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CHAPTER OVERVIEW

9: Marketing- Providing Value to Customers

- 9.1: 0 Cases and Problems
- 9.2: What Is Marketing?
- 9.3: The Marketing Mix
- 9.4: Pricing a Product
- 9.5: Placing a Product
- 9.6: Promoting a Product
- 9.7: Interacting with Your Customers
- 9.8: The Product Life Cycle
- 9.9: The Marketing Environment
- 9.10: Careers in Marketing

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9.1: 0 Cases and Problems

Learning on the Web (AACSB)

The Economics of Online Annoyance

You've just accessed a Web page and begun searching for the information you want to retrieve. Suddenly the page is plastered from top to bottom with *banner ads*. Some pop up, some float across the screen, and in some, animated figures dance and prance to inane music. As a user of the Internet, feel free to be annoyed. As a student of business, however, you should stop and ask yourself a few questions: Where do banner ads come from? Who stands to profit from them?

To get a handle on these questions, go to the How Stuff Works Web site (<http://computer.howstuffworks.com/web-advertising.htm>) and read the article "How Web Advertising Works," by Marshall Brain. When you've finished, answer the following questions *from the viewpoint of a company advertising on the Web*:

1. What are the advantages and disadvantages of banner ads? Why are they less popular with advertisers today than they were about ten years ago?
2. What alternative forms of Web advertising are more common today? (For each of these alternative forms, describe the type of ad, explain how it's more effective than banner advertising, and list any disadvantages.)
3. Why are there so many ads on the Web? Is it easy to make money selling ads on the Web? Why, or why not?
4. Assume that you're in charge of Web advertising for a company that sells cell-phone ring tones. On which sites would you place your ads and what type of ads would you use? Why?

Career Opportunities

So Many Choices

How would you like to work for an advertising agency? How about promoting a new or top-selling brand? Want to try your hand at sales? Or does marketing research or logistics management sound more appealing? With a marketing degree, you can pursue any of these career options—and more. To learn more about these options, go to the WetFeet Web site (wetfeet.com/Careers-Industries.aspx). Scroll down to the "Careers" section and select **two** of the following career options that interest you: advertising, brand management, marketing, sales, or supply chain management. For each of the two selected, answer the following questions:

1. What would you do if you worked in this field?
2. Who does well?
3. What requirements are needed to be hired into this field?
4. Are job prospects in the field positive or negative?
5. What career track would you follow?

Finally, write a paragraph responding to these questions: Does a career in marketing appeal to you? Why, or why not? Which career option do you find most interesting? Why?

Ethics Angle (AACSB)

Pushing Cigarettes Overseas

A senior official of the United Nation's World Health Organization (WHO) claims that the marketing campaigns of international tobacco companies are targeting half a billion young people in the Asia Pacific region by linking cigarette smoking to glamorous and attractive lifestyles. WHO accuses tobacco companies of "falsely associating use of their products with desirable qualities such as glamour, energy and sex appeal, as well as exciting outdoor activities and adventure" (Agence France Presse, 2008). WHO officials have expressed concern that young females are a major focus of these campaigns.

The organization called on policymakers to support a total ban on tobacco advertising saying that "the bombardment of messages through billboards, newspapers, magazines, radio and television ads, as well as sports and fashion sponsorships and other ploys, are meant to deceive young people into trying their first stick" (Associated Press, 2008). WHO stresses the need for a total ban on advertising as partial bans let tobacco companies switch from one marketing scheme to another.

WHO officials believe that extensive tobacco advertising gives young people the false impression that smoking is normal and diminishes their ability to comprehend that it can kill. Representatives of the organization assert that the tobacco industry is taking advantage of young people's vulnerability to advertising.

Instructions: Read the following articles and provide your opinion on the questions that follow:

- Agence France Presse (AFP), "WHO: Half a Billion Young Asians at Risk from Tobacco Addiction," May 31, 2008, afp.google.com/article/ALeqM5...asEdZ20BsmiDfQ.
- Associated Press, "WHO Criticizes Tobacco Industry Focus on Asian Young People," May 30, 2008, www.chinapost.com.tw/news/200...criticizes.htm
- Were Blockbuster's actions unethical?

Provide your opinion on the following :

- U.S. laws prohibit advertising by the tobacco companies. Should developing countries in which cigarette smoking is promoted by the international tobacco companies follow suit—should they also ban tobacco advertising?
- Are U.S. companies that engage in these advertising practices acting unethically? Why or why not?
- Should international policymakers support a total ban on tobacco advertising? Why or why not?
- If tobacco advertising was banned globally, what would be the response of the international tobacco companies?

Team-Building Skills (AACSB)

Build a Better iPod and They Will Listen

Right now, Apple is leading the pack of consumer-electronics manufacturers with its extremely successful iPod. But that doesn't mean that Apple's lead in the market can't be surmounted. Perhaps some enterprising college students will come up with an idea for a better iPod and put together a plan for bringing it to market. After all, Apple founders (the late Steve Jobs and Stephen Wozniak) were college students (actually, college dropouts) who found entrepreneurship more rewarding than scholarship. Here's your team assignment for this exercise:

1. Select a target market for your product.
2. Develop your product so that it offers features that meet the needs of your target market.
3. Describe the industry in which you'll compete.
4. Set a price for your product and explain your pricing strategy.
5. Decide what distribution channels you'll use to get your product to market.
6. Develop a promotion mix to create demand for your product.

The Global View (AACSB)

Made in China—Why Not Sell in China?

One of Wow Wee's recent robots, Roboscooper, is manufactured in China. Why shouldn't it sell the product in China? In fact, the company has introduced its popular robot to the Chinese market through a Toys "R" Us store in Hong Kong. Expanding into other parts of China, however, will require a well-crafted, well-executed marketing plan. You're director of marketing for Wow Wee, and you've been asked to put together a plan to expand sales of Roboscooper in China. You can be introduced to Roboscooper by going to the product section of Wow Wee's site: <http://www.wowwee.com/en/products/to...cs/roboscooper>. To get some background on selling toys in China, go to the Epoch Times Web site (en.epochtimes.com/news/4-12-23/25184.html) and read the article "China Could Soon Become Booming Toy Market." Then, draw up a brief marketing plan for increasing sales in China, being sure to include all the following components:

- Profile of your target market (gender, age, income level, geographic location, interests, and so forth)
- Proposed changes to the company's current marketing mix: modifications to product design, pricing, distribution, and promotional strategies
- Estimated sales in units for each of the next five years, including a list of the factors that you considered in arriving at your projections
- Discussion of threats and opportunities posed by expansion in the Chinese market

References

Agence France Presse, "WHO: Half a Billion Young Asians at Risk from Tobacco Addiction," May 31, 2008, afp.google.com/article/ALeqM5...asEdZ20BsmiDfQ (accessed January 22, 2012).

Associated Press, "WHO Criticizes Tobacco Industry Focus on Asian Young People," May 30, 2008, www.iht.com/articles/ap/2008/05/30/news/Asia-Young-Smokers.php (accessed January 22, 2012).

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9.2: What Is Marketing?

Learning Objectives

1. Define the terms marketing, marketing concept, and marketing strategy.
2. Outline the tasks involved in selecting a target market.

When you consider the functional areas of business—accounting, finance, management, marketing, and operations—marketing is the one you probably know the most about. After all, as a consumer and target of all sorts of advertising messages, you've been on the receiving end of marketing initiatives for most of your life. What you probably don't appreciate, however, is the extent to which marketing focuses on providing value to the customer. According to the American Marketing Association, "Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large" (American Marketing Association, 2011).

In other words, marketing isn't just advertising and selling. It includes everything that organizations do to satisfy customer needs:

- Coming up with a product and defining its features and benefits
- Setting its price
- Identifying its target market
- Making potential customers aware of it
- Getting people to buy it
- Delivering it to people who buy it
- Managing relationships with customers after it has been delivered

Not surprisingly, marketing is a team effort involving everyone in the organization. Think about a typical business—a local movie theater, for example. It's easy to see how the person who decides what movies to show is involved in marketing: he or she selects the product to be sold. It's even easier to see how the person who puts ads in the newspaper works in marketing: he or she is in charge of advertising—making people aware of the product and getting them to buy it. But what about the ticket seller and the person behind the counter who gets the popcorn and soda? What about the projectionist? Are they marketing the business? Absolutely: the purpose of every job in the theater is satisfying customer needs, and as we've seen, identifying and satisfying customer needs is what marketing is all about.

If everyone is responsible for marketing, can the average organization do without an official marketing department? Not necessarily: most organizations have marketing departments in which individuals are actively involved in some marketing-related activity—product design and development, pricing, promotion, sales, and distribution. As specialists in identifying and satisfying customer needs, members of the marketing department manage—plan, organize, direct, and control—the organization's overall marketing efforts.

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9.3: The Marketing Mix

Learning Objectives

1. Identify the four Ps of the marketing mix.
2. Explain how to conduct marketing research.
3. Discuss various branding strategies and explain the benefits of packaging and labeling.

After identifying a target market, your next step is developing and implementing a marketing program designed to reach it. As Figure 9.4 “The Marketing Mix” shows, this program involves a combination of tools called the marketing mix, often referred to as the “four Ps” of marketing:

1. Developing a *product* that meets the needs of the target market
2. Setting a *price* for the product
3. Distributing the product—getting it to a *place* where customers can buy it
4. *Promoting* the product—informing potential buyers about it

Figure 9.4 The Marketing Mix



The goal is to develop and implement a marketing strategy that combines these four elements. To see how this process works, let's look at Wow Wee Toys' marketing program for Robosapien (Wow Wee Toys Ltd., 2004).

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9.4: Pricing a Product

Learning Objective

1. Identify pricing strategies that are appropriate for new and existing products.

The second of the four Ps in the marketing mix is price. Pricing a product involves a certain amount of trial and error because there are so many factors to consider. If you price too high, a lot of people simply won't buy your product. Or you might find yourself facing competition from some other supplier that thinks it can beat your price. On the other hand, if you price too low, you might not make enough profit to stay in business. So how do you decide on a price? Let's look at several pricing options that were available to those marketers at Wow Wee who were responsible for pricing Robosapien. We'll begin by discussing two strategies that are particularly applicable to products that are being newly introduced.

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9.5: Placing a Product

Learning Objectives

1. Explore various product-distribution strategies.
2. Explain how companies create value through effective supply chain management.

The next element in the marketing mix is *place*, which refers to strategies for *distribution*. Distribution entails all activities involved in getting the right quantity of your product to your customers at the right time and at a reasonable cost. Thus, distribution involves selecting the most appropriate *distribution channels* and handling the *physical distribution* of products.

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9.6: Promoting a Product

Learning Objective

1. Describe the elements of the promotion mix.

Your promotion mix—the means by which you communicate with customers—may include advertising, personal selling, sales promotion, and publicity. These are all tools for telling people about your product and persuading potential customers, whether consumers or organizational users, to buy it. Before deciding on an appropriate promotional strategy, you should consider a few questions:

- What's the main purpose of the promotion? Am I simply trying to make people aware of my product, or am I trying to get people to buy it right now? Am I trying to develop long-term customers? Am I trying to connect with my current customers? Am I trying to promote my company's image?
- What's my target market? What's the best way to reach it?
- Which product features (quality, price, service, availability, innovativeness) should I emphasize? How does my product differ from those of competitors?
- How much can I afford to invest in a promotion campaign?
- How do my competitors promote their products? Should I take a similar approach?

To promote a product, you need to imprint a clear image of it in the minds of your target audience. What do you think of, for instance, when you hear “Ritz-Carlton”? What about “Motel 6”? They’re both hotel chains, but the names certainly conjure up different images. Both have been quite successful in the hospitality industry, but they project very different images to appeal to different clienteles. The differences are evident in their promotions. The Ritz-Carlton Web site describes “luxury hotels” and promises that the chain provides “the finest personal service and facilities throughout the world” (Ritz-Carlton, 2011). Motel 6, by contrast, characterizes its facilities as “discount hotels” and assures you that you’ll pay “discount hotel rates” (Motel 6, 2011).

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9.7: Interacting with Your Customers

Learning Objectives

1. Explain how companies manage customer relationships.
2. Describe social media marketing and identify its advantages and disadvantages.

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9.8: The Product Life Cycle

Learning Objective

1. Explain how a product moves through its life cycle and how this brings about shifts in marketing-mix strategies.

Figure 9.12



LEGO has decided to go back to basics and focus on the classic bricks rather than complicated kits.

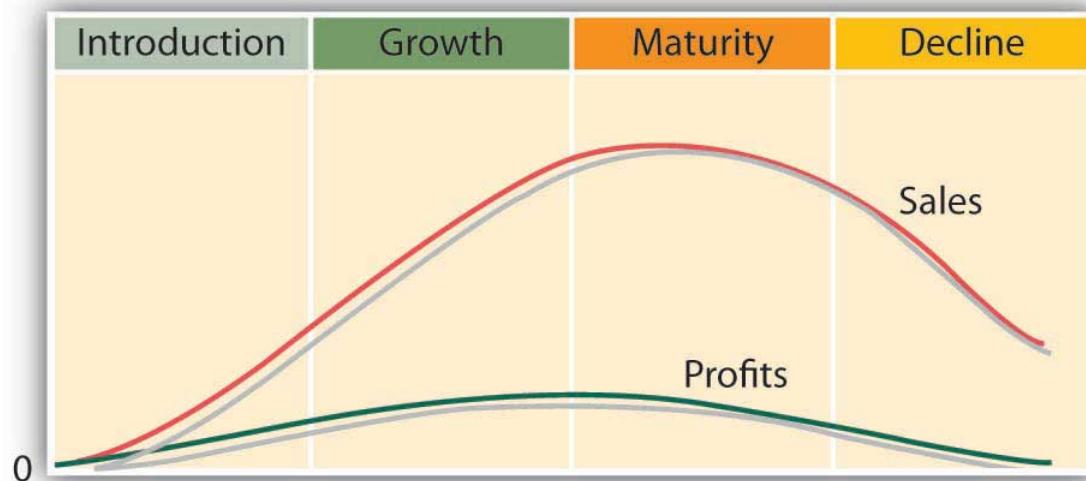
Mark Nicolson – [Lego house](#) – CC BY 2.0.

Did you play with LEGO blocks when you were a kid? Almost everyone did. They were a big deal. Store shelves were stacked with boxes of plastic bricks, wheels, and windows, plus packages containing just the pieces you needed to make something special, like a LEGO helicopter. McDonald's put LEGO sets in Happy Meals. If you walk down a toy-store aisle today, you'll still find LEGOs. They're shelved alongside the XBOX Kinect, Buzz Lightyear, and other playthings that appeal to contemporary kids. Like these products, they're more sophisticated. They're often tied in with movies, such as *Toy Story*, *Cars*, *Star Wars*, and *Harry Potter*.

Nowadays, the seventy-nine-year old Denmark company is doing very well: in 2010, its sales rose 37 percent and profits were up 70 percent (Reuters, 2011). The LEGO Group has moved its way up to the fifth largest toy company in the world based on sales (Brown, 2011). Things were very different seven years earlier—LEGO sales had declined drastically in the early 2000s. In its 2003 annual report, its CEO admitted that “2003 was a very disappointing year for LEGO Company.” Net sales fell by 26 percent, resulting in a loss in earnings for the year and significant decline in market share. LEGO planned to drop many of its recent initiatives and focus on its classic LEGO brick products (LEGO Group, 2003).

Let's look closer and find out what happened to the LEGO brand prior to its turnaround seven years ago. It was moving through stages of development and decline (KeepMedia, 2004; KeepMedia, 2004; Fishman, 2001). Marketers call this process the product life cycle, which is illustrated in Figure 9.13 “The Product Life Cycle”. In theory, it's a lot like the life cycle that people go through. Once it's developed, a new product is *introduced* to the market. With any success at all, it begins to *grow*, attracting more buyers. At some point, the market stabilizes, and the product becomes *mature*. Eventually, however, its appeal diminishes, and it's overtaken by competing brands or substitute products. Sales *decline*, and it's ultimately taken off the market.

Figure 9.13 The Product Life Cycle



This is a simplified version of the cycle. There are lots of exceptions to the product life-cycle rules. For one thing, most products never make it past the introduction stage; they die an early death. Second, some products (like some people) avoid premature demise by reinventing themselves. This is what the LEGO Group did. The company had been reinventing itself during the fifteen-year period of 1990 to 2005, launching new products in an effort to recover its customer base and overcome a series of financial crises. Unfortunately, this strategy was unsuccessful. As pointed out by its CEO, the introduction of new products and the resulting costs “have not produced the desired results. In some cases,” admits the company, “new products have even cannibalized on the sales of LEGO Company’s core products and thus eroded earnings” (LEGO Group, 2003).

A take-over threat by Mattel Toy Company forced its CEO into action (Batra, 2010). His first stop in formulating a resurrection plan was to fly to Virginia and attend a convention for adult fans of LEGO's. The attendees' stories of how LEGOs helped shape their minds gave him hope that the family-owned company could be saved. He returned to Denmark and put into place a plan that included downsizing the number of employees, selling its LEGOLAND theme parks, simplifying product designs, cutting unprofitable product lines, and focusing on what made the company great: LEGO building blocks.

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9.9: The Marketing Environment

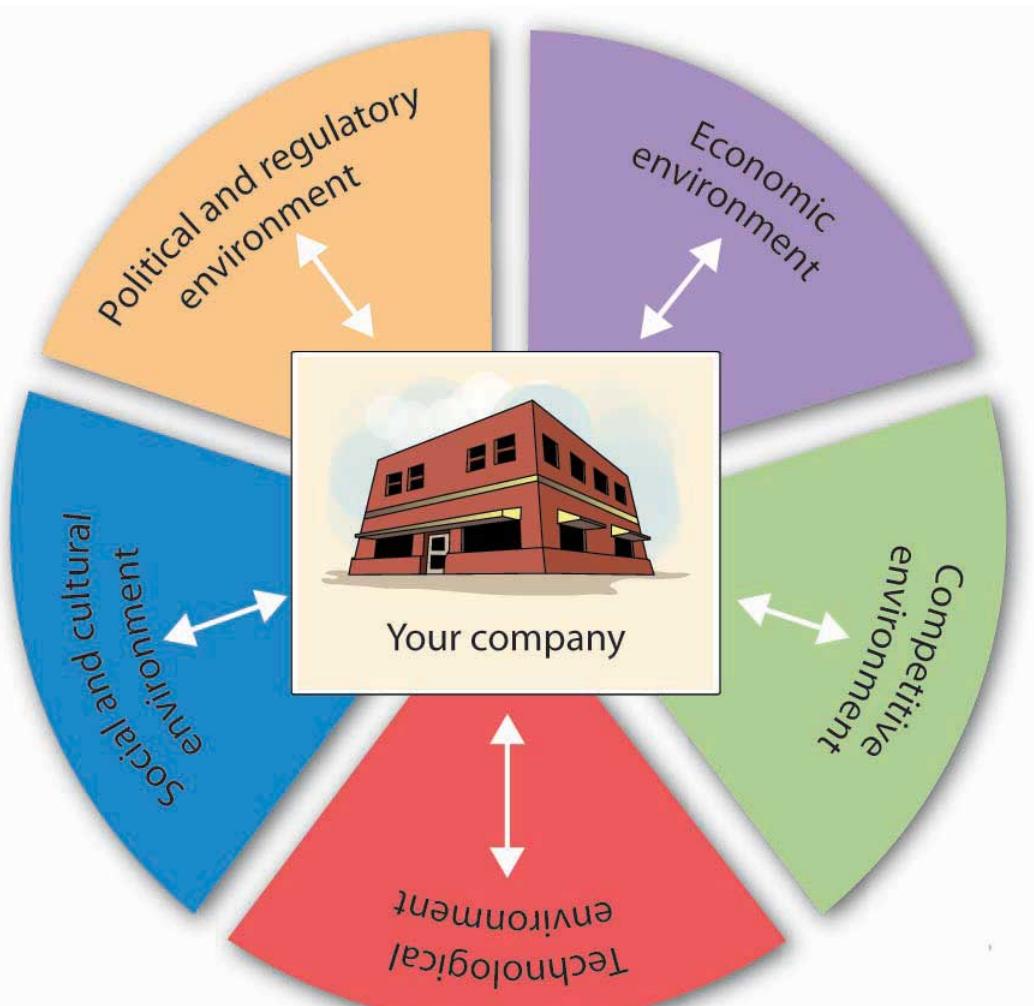
Learning Objectives

1. Describe the external marketing environment in which businesses operate.
2. Discuss the factors that influence consumer behavior.

By and large, managers can control the four Ps of the marketing mix: they can decide which products to offer, what prices to charge for them, how to distribute them, and how to reach target audiences. Unfortunately, there are other forces at work in the marketing world—forces over which marketers have much less control. These forces make up a company's external marketing environment, which, as you can see in Figure 9.14 "The Marketing Environment", we can divide into five sets of factors:

1. Political and regulatory
2. Economic
3. Competitive
4. Technological
5. Social and cultural

Figure 9.14 The Marketing Environment



These factors—and changes in them—present both threats and opportunities that require shifts in marketing plans. To spot trends and other signals that conditions may be in flux, marketers must continually monitor the environment in which their companies

operate. To get a better idea of how they affect a firm's marketing activities, let's look at each of the five areas of the external environment.

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9.10: Careers in Marketing

Learning Objective

1. Describe opportunities in the field of marketing.

The field of marketing is extensive, and so are the opportunities for someone graduating with a marketing degree. While one person may seek out the excitement of an advertising agency that serves multiple clients, another might prefer to focus on brand management at a single organization. For someone else, working as a buyer for a retail chain is appealing. A few people might want to get into marketing research. Others might have an aptitude for supply chain management or *logistics management*, the aspect of supply chain management that focuses on the flow of products between suppliers and customers. Many people are attracted to sales positions because of the potential financial rewards. Let's look more closely at a few of your options.

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CHAPTER OVERVIEW

10: Product Design and Development

- 10.1: What Is a Product?
- 10.2: Where Do Product Ideas Come From?
- 10.3: Identifying Business Opportunities
- 10.4: Understand Your Industry
- 10.5: Forecasting Demand
- 10.6: Breakeven Analysis
- 10.7: Product Development
- 10.8: Protecting Your Idea
- 10.9: Cases and Problems

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10.1: What Is a Product?

Learning Objectives

1. Define *product*.
2. Describe the four major categories of product developments: new-to-the-market, new-to-the-company, improvement of existing product, and extension of product line.

Basically, a product is something that can be marketed to customers because it provides them with a benefit and satisfies a need. It can be a physical *good*, such as the PowerSki Jetboard, or a *service*, such as a haircut or a taxi ride. The distinction between goods and services isn't always clear-cut. Say, for example, that a company hires a professional to provide an in-house executive training program on "netiquette" (e-mail etiquette). Off the top of our heads, most of us would say that the company is buying a service. What if the program is offered online? We'd probably still argue that the product is a service. But what if the company buys training materials that the trainer furnishes on DVD? Is the customer still buying a service? Probably not: we'd have to say that when it buys the DVD, the company is buying a tangible good.

In this case, the product that satisfies the customer's need has both a tangible component (the training materials on DVD) and an intangible component (the educational activities performed by the seller). Not surprisingly, many products have both tangible and intangible components. If, for example, you buy a Hewlett-Packard computer, you get not only the computer (a tangible good) but certain promises to answer any technical questions that you might have and certain guarantees to fix your computer if it breaks within a specified time period (intangible services).

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10.2: Where Do Product Ideas Come From?

Learning Objective

1. Explain where product ideas come from.

For some people, coming up with a great product idea is a gratifying adventure. For most, however, it's a daunting task. The key to coming up with a product idea is identifying something that customers want—or, perhaps more important, filling an unmet customer need. In coming up with a product idea, ask not “what do I want to sell?” but rather “what does the customer want to buy?” (Thurm, 2005) With this piece of advice in mind, let's get back to the task of coming up with a product idea. Nobel Prize-winning chemist Linus Pauling suggested that “the best way to have a good idea is to have lots of ideas,” and though this notion might seem a little whimsical at first, it actually makes a lot of sense, especially if you're trying to be innovative in the entrepreneurial sense. Every year, for example, companies launch about thirty thousand new food, beverage, and beauty products, and up to 90 percent fail within a year (Catalina, 2011; Kotler & Armstrong, 2008). You might need ten good ideas just to have one that stands a chance.

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10.3: Identifying Business Opportunities

Learning Objectives

1. Explain how an idea turns into a business opportunity.
2. Describe the four types of utility provided by a product: time, place, ownership, and form.

An idea turns into a business opportunity when it has commercial potential—when you can make money by selling the product. But needless to say, not all ideas generate business opportunities. Consider these products that made the list of the “Top 25 Biggest Product Flops of All Time” (WalletPop, 2011):

- *Bic underwear.* When you think of Bic you think of inexpensive pens and disposable razors and lighters. But disposable underwear? Women didn’t find the idea of buying intimate attire from a pen manufacturer appealing, and the disposability factor was just plain weird.

Figure 10.3



There might be many creative ways for Bic to extend its product lines, aside from the disposable underwear idea. Can you think of a product idea that might be more successful for Bic?

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10.4: Understand Your Industry

Learning Objective

1. Explain how to research an industry.

Before you invest a lot of time and money to develop a new product, you need to understand the industry in which it's going to be sold. As inventor of the PowerSki Jetboard, Bob Montgomery had the advantage of being quite familiar with the industry that he proposed to enter. With more than twenty years' experience in the water-sports and personal-watercraft industry, he felt at home in this business environment. He knew who his potential customers were, and he knew who his competitors were. He had experience in marketing similar products, and he was familiar with industry regulations.

Most people don't have the same head start as Montgomery. So, how does the average would-be businessperson learn about an industry? What should you want to know about it? Let's tackle the first question first.

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10.5: Forecasting Demand

Learning Objective

1. Forecast demand for a product.

It goes without saying, but we'll say it anyway: without enough customers, your business will go nowhere. So, before you delve into the complex, expensive world of developing and marketing a new product, ask yourself questions like those in Figure 10.5 "When to Develop and Market a New Product". When Bob Montgomery asked himself these questions, he concluded that he had two groups of customers for the PowerSki Jetboard: (1) the dealerships that would sell the product and (2) the water-sports enthusiasts who would buy and use it. His job, therefore, was to design a product that dealers would want to sell and enthusiasts would buy. When he was confident that he could satisfy these criteria, he moved forward with his plans to develop the PowerSki Jetboard.

Figure 10.5 When to Develop and Market a New Product

Ask yourself:

1

Who are my primary customers?

2

Will I sell to individuals, businesses, or both?

3

If I sell to other businesses, who will be the actual end users, or ultimate consumers, of my product?

After you've identified a group of potential customers, your next step is finding out as much as you can about what they think of your product idea. Remember: because your ultimate goal is to roll out a product that satisfies customer needs, you need to know ahead of time what your potential customers want. Precisely what are their unmet needs? Ask them questions such as these (Ulrich & Eppinger, 2000; Allen, 2001):

- What do you like about this product idea? What don't you like?
- What improvements would you make?
- What benefits would you get from it?
- Would you buy it? Why, or why not?
- What would it take for you to buy it?

Before making a substantial investment in the development of a product, you need to ask yourself yet another question: are there enough customers willing to buy my product at a price that will allow me to make a profit? Answering this question means

performing one of the hardest tasks in business: forecasting demand for your proposed product. There are several possible approaches to this task that can be used alone or in combination.

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10.6: Breakeven Analysis

Learning Objective

1. Learn how to use breakeven analysis to estimate the number of sales units at which net income is zero.

Forecasting sales of shoes has started you thinking. Selling twelve thousand pair of shoes the first year you run the business sounds great, but you still need to find an answer to the all-important question: are there enough customers willing to buy my jogging shoes at a price that will allow me to make a profit? Is there some way to figure out the level of sales I would need to avoid *losing* money—to “break even”? Fortunately, an accountant friend of yours informs you that there is. Not surprisingly, it’s called breakeven analysis, and here’s how it works: to break even (have no profit or loss), *total sales revenue must exactly equal all your expenses (both variable and fixed)*. To determine the level of sales at which this will occur, you need to do the following:

1. Fixed costs = \$210,000 salaries + \$60,000 rent + \$10,000 advertising + \$8,000 insurance + 12,000 other fixed costs = \$300,000
2. Variable cost per unit = \$40 (cost of each pair of shoes) + \$5 sales commission = \$45
3. Contribution margin per unit = \$80 selling price minus \$45 variable cost per unit = \$35
4. Breakeven in units = \$300,000 fixed costs ÷ \$35 contribution margin per unit = 8,571 units

Your calculation means that if you sell 8,571 pairs of shoes, you will end up with zero profit (or loss) and will exactly break even.

If your sales estimate is realistic (a big “if”), then you should be optimistic about starting the business. All your fixed costs will be covered once you sell 8,571 pairs of shoes. Any sales above that level will be pure profit. So, if you sell your expected level of twelve thousand pairs of shoes, you’ll make a profit of \$120,015 for the first year. Here’s how we calculated that profit:

- 12,000 expected sales level – 8,571 breakeven sales level = 3,429 units × \$35 contribution margin per unit = \$120,015 first-year profit

As you can see, breakeven analysis is pretty handy. It allows you to determine the level of sales that you must reach to avoid losing money and the profit you’ll make if you reach a higher sales goal. Such information will help you plan for your business.

Key Takeaways

- Breakeven analysis is a method of determining the level of sales at which the company will break even (have no profit or loss).
- The following information is used in calculating the breakeven point: fixed costs, variable costs, and contribution margin per unit.
- Fixed costs are costs that don’t change when the amount of goods sold changes. For example, rent is a fixed cost.
- Variable costs are costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis. For example, sales commissions paid based on unit sales are a variable cost.
- Contribution margin per unit is the excess revenue per unit over the variable cost per unit.
- The breakeven point in units is calculated with this formula: fixed costs divided by contribution margin per unit (selling price per unit less variable cost per unit).

Exercise

(AACSB) Analysis

For the past ten years, you’ve worked at a PETCO Salon as a dog groomer. You’re thinking of starting your own dog grooming business. You found a place you could rent that’s right next to a popular shopping center, and two of your friends (who are also dog groomers) have agreed to work for you. The problem is that you need to borrow money to start the business and your banker has asked for a breakeven analysis. You have prepared the following cost estimates for your first year of operations:

Fixed Costs	
Salaries	\$105,000
Rent and utilities	\$36,000
Advertising	\$2,000
Equipment	\$3,000

Variable Cost per Dog

Shampoo	\$2.00
Coat conditioner	\$1.50
Pet cologne	\$0.75
Dog treats	\$1.25
Hair ribbons	\$0.50

You went online and researched grooming prices in your area. Based on your review, you have decided to charge \$32 for each grooming.

- Part 1:
 - What's the breakeven point in units—how many dogs will you need to groom in the first year to break even?
 - If you and your two employees groomed dogs five days a week, seven hours a day, fifty weeks a year, how many dogs would each of you need to groom each day? Is this realistic given that it takes one hour to groom a dog?
- Part 2:
 - If you raised your grooming fee to \$38, how many dogs would you need to groom to break even?
 - At this new price, how many dogs will each of you have to groom each day (assuming, again, that the three of you groom dogs fifty weeks a year, five days a week, seven hours a day)?
- Part 3:
 - Would you start this business?
 - What price would you charge to groom a dog?
 - How could you lower the breakeven point and make the business more profitable?

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10.7: Product Development

Learning Objective

1. Describe the process of developing a product that meets customer needs.

Like PowerSki, every organization—whether it produces goods or provides services—sees Job 1 as furnishing customers with quality products. The success of a business depends on its ability to identify the unmet needs of consumers and to develop products that meet those needs at a low cost (Ulrich & Eppinger, 2000). In other words, effective product development results in goods and services that can be sold at a profit. In addition, it results in high-quality products that not only satisfy consumer needs but also can be developed in a timely, cost-efficient manner. Accomplishing these goals entails a collaborative effort by individuals from all areas of an organization: operations management (including representatives from engineering, design, and manufacturing), marketing, accounting, and finance. In fact, companies increasingly assign representatives from various functional areas who work together as a project team throughout the product development processes. This approach allows individuals with varied backgrounds and experience to provide input as the product is being developed.

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10.8: Protecting Your Idea

Learning Objective

1. Learn how to protect your product idea by applying for a patent.

You can protect your rights to your idea with a patent from the U.S. Patent and Trademark Office, which grants you “the right to exclude others from making, using, offering for sale, or selling” the invention in the United States for twenty years (U.S. Patent and Trademark Office, 2011).

What do you need to know about applying for a patent? For one thing, document your idea as soon as you think of it. Simply fill out a form, stating the purpose of your invention and the current date. Then sign it and get someone to witness it. The procedure sounds fairly informal, but you may need this document to strengthen your claim that you came up with the idea before someone else who also claims it. Later, you’ll apply formally for a patent by filling out an application (generally with the help of a lawyer), sending it to the U.S. Patent and Trademark Office, and waiting. Nothing moves quickly through the U.S. Patent and Trademark Office, and it takes a long time for any application to get through the process.

Will your application get through at all? There’s a good chance if your invention meets all the following criteria:

- *It’s new.* No one else can have known about it, used it, or written about it before you filed your patent application (so keep it to yourself until you’ve filed).
- *It’s not obvious.* It has to be sufficiently different from everything that’s been used for the purpose in the past (you can’t patent a new color for a cell phone).
- *It has utility.* It can’t be useless; it must have some value.

Applying for a U.S. patent is only the first step. If you plan to export your product outside the United States, you’ll need patent protection in each country in which you plan to do business, and as you’ve no doubt guessed, getting a foreign patent isn’t any easier than getting a U.S. patent. The process keeps lawyers busy: during a three-year period, PowerSki International had to take out more than eighty patents on the PowerSki Jetboard. It still has a long way to go to match the number of patents issued to some extremely large corporations. Microsoft, for example, recently obtained its ten thousandth patent (Fried, 2011).

Clearly, the patent business is booming. The U.S. Patent and Trademark Office issued more than a half million patents in 2010 (U.S. Patent and Trademark Office, 2011). One reason for the recent proliferation of patents is the high-tech boom: over the last decade, the number of patents granted has increased by more than 50 percent.

Key Takeaways

- You can protect your rights to your idea with a **patent** from the U.S. Patent and Trademark Office.
- A patent grants you “the right to exclude others from making, using, offering for sale, or selling” the invention in the United States for twenty years.
- To be patentable, an invention must meet all the following criteria: it’s new (no one else can have known about it, used it, or written about it before you filed your patent application); it’s not obvious (it’s sufficiently different from everything that’s been used for the purpose in the past); and it has utility (it must have some value; it can’t be useless).

Exercise

(AACSB) Analysis

A friend of yours described a product idea she had been working on. It is a child’s swing set with a sensor to stop the swing if anyone walks in front of it. She came to you for advice on protecting her product idea. What questions would you need to ask her to determine whether her product idea is patentable? How would she apply for a patent? What protection would the patent give her? How long would the patent apply?

References

Fried, I., “Microsoft Gets 10,000th Patent,” *CNET News*, news.cnet.com/8301-13860_3-10157884-56.html (accessed October 28, 2011).

U.S. Patent and Trademark Office, <http://www.uspto.gov/web/patents/howtopat.htm> (accessed October 28, 2011).

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10.9: Cases and Problems

Learning on the Web (AACSB)

Breaking Even on Burgers

You and your business partner plan to open a gourmet burger restaurant. Your partner estimated the new business will sell a hundred fifty thousand burgers during its first year and a half of operations. You want to determine the number of burgers you must sell to break even during this period.

Here are the figures you know so far:

- The variable cost for each burger is \$0.97 each.
- The fixed cost of making burgers for eighteen months is \$140,000 (this includes costs such as rent, utilities, insurance).
- You will sell your burgers for \$1.99 each.
- At the \$1.99 per-unit selling price, how many burgers will you have to sell to break even?

Part 1: Using the previous information, manually calculate the breakeven number of burgers. How close is the breakeven number of burgers to your partner's sales estimate of one hundred fifty thousand burgers? How confident are you that your restaurant will be profitable?

Part 2: Now, recalculate the breakeven number of burgers using a higher selling price. Pretend that your likely customers are burger fanatics and will pay \$2.79 for a burger (rather than \$1.99). Also pretend that the variable cost for each burger and your fixed costs won't change (variable cost per burger is still \$0.97 and fixed costs are still \$140,000). Manually calculate the number of burgers you must sell to break even at this higher selling price. Are you now more confident that the business will succeed?

Part 3: Without recalculating breakeven, answer these two questions:

1. If the variable cost for each burger went down from \$0.97 to \$0.80 per burger (and your selling price stayed at \$1.99), would you need to sell more or fewer burgers to break even?
2. If fixed costs went down from \$140,000 to \$100,000 (and your selling price stayed at \$1.99 and variable cost per burger returned to \$0.97), would you need to sell more or fewer burgers to break even?

Career Opportunities

Being a “Big Idea” Person

Imagine a career in which you design the products people use every day. If you're a “big idea” person, have an active imagination, have artistic flair, and possess the ability to understand how products function, then a career in product design and development might be for you. To learn what opportunities are available in this field, go to the Job Bank section of the Product Development and Management Association's Web site (www.pdma.org/job_bank.cfm) and click on “View Posted Jobs.” Explore the various job openings by clicking on a position (to highlight it); and then clicking on the “View Job Details” button at the bottom of the screen. Find a position that interests you and look for answers to these questions:

1. What's the job like?
2. What educational background, work experience, and skills are needed for the job?
3. What aspects of the job appeal to you? What aspects are unappealing?
4. Are you cut out for a career in product design and development? Why, or why not?

Ethics Angle (AACSB)

Who's Getting Fat from Fast Food?

Product liability laws cover the responsibility of manufacturers, sellers, and others for injuries caused by defective products. Under product liability laws, a toy manufacturer can be held liable if a child is harmed by a toy that's been marketed with a design flaw. The manufacturer can also be held liable for defects in marketing the toy, such as giving improper instructions on its use or failing to warn consumers about potential dangers. But what if the product isn't a toy, but rather a fast-food kid's meal? And what if the harm isn't immediately obvious but emerges over time?

These questions are being debated in the legal and health professions (and the media). Some people believe that fast-food restaurants should be held responsible (at least in part) for childhood obesity. They argue that fast-food products—such as kids'

meals made up of high-calorie burgers, fried chicken fingers, French fries, and sugary soft drinks—are helping to make U.S. children overweight. They point out that while restaurant chains spend billions each year to advertise fast food to children, they don't do nearly enough to warn parents of the dangers posed by such foods. On the other side of the debate are restaurant owners, who argue that they're not the culprits. They say that their food can be a part of a child's diet—if it's eaten in moderation.

There's no disputing that 15 percent of American children are obese and that fast-food consumption by children has increased by 500 percent since 1970. Most observers also accept the data furnished by the U.S. Surgeon General: that obesity in the United States claims some three hundred thousand lives a year and costs \$117 billion in health care. The controversy centers on the following questions:

1. Who really is to blame for the increase in obesity among U.S. children?
2. Under current consumer-protection laws, is fast-food marketing aimed at children misleading?
3. Should fast-food restaurants be held legally liable for the health problems associated with their products?

What's your opinion? If you owned a fast-food restaurant, what action (if any) would you take in response to the charges leveled by critics of your industry?

Team-Building Skills (AACSB)

The Great Idea

Get together with members of your team and brainstorm ideas for a new-to-the-market product. Begin the brainstorming session by asking each person to write an idea on a sticky note. Post the idea and repeat the process four times. After the team has evaluated and discussed the ideas, all members should vote. Each gets ten votes, which can be placed on one idea or spread over many. Once the voting ends, add up the votes received by each idea and declare one idea the winner.

Write a group report that answers the following questions:

1. What is the idea?
 2. How would the idea work?
 3. Who would our customers be?
 4. What unmet need does it fill?
2. Industry
- What is the product's industry, segment, and niche?
 - Is the industry growing or contracting?
 - Who are our major competitors?
 - How does our product differ from those of our competitors?
 - What opportunities exist in the industry? What threats?
3. Product
- What will the product look like?
 - What features will it have?
 - How will customers benefit from our product?
 - Why will customers buy the product from us?
 - Why will our product be financially successful?

The Global View (AACSB)

What to Do When the “False” Alarm Goes Off

If someone on the street tried to sell you a “Rolex” watch for \$20, you'd probably suspect that it's a fake. But what about a pair of New Balance athletic shoes? How do you know they're authentic? How can you tell? Often you can't. Counterfeitors are getting so good at copying products that even experts have trouble telling a fake from the real thing. What if the counterfeit product in question was a prescription drug? Even worse, what if it had been counterfeited with unsterile equipment or contained no active ingredients?

How likely is it that you'll buy a counterfeit product in the next year? Unfortunately, it's very likely. To learn a little more about the global counterfeiting business, go to the *BusinessWeek* and *Washington Post* Web sites. Read the *BusinessWeek* article “Fakes!”

(http://www.businessweek.com/magazine...9001_mz001.htm) and the *Washington Post* article “Counterfeit Goods That Trigger the ‘False’ Alarm” (<http://www.highbeam.com/doc/1P2-4576.html>). After you read these articles, answer the following questions:

1. How has the practice of counterfeiting changed over time? What factors have allowed it to escalate?
2. What types of products are commonly counterfeited, and why might they be unsafe? What counterfeit products are particularly dangerous?
3. How do the counterfeiters get goods onto the market? How can you reduce your chances of buying fake goods?
4. Why is counterfeiting so profitable? How can counterfeiters compete on price with those making the authentic goods? How do counterfeiters harm U.S. businesses?
5. What efforts are international companies and governments (including China) making to stop counterfeiters?
6. If you know that a product is fake, is it ethical to buy it?

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CHAPTER OVERVIEW

11: Operations Management in Manufacturing and Service Industries

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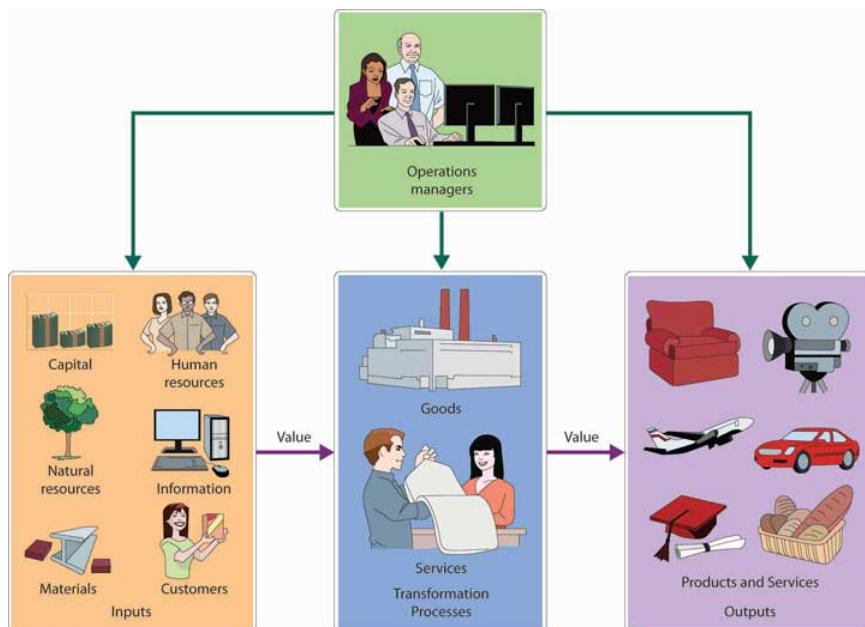
11.1: Operations Management in Manufacturing

Learning Objectives

1. Define operations management, and discuss the role of the operations manager in a manufacturing company.
2. Describe the decisions made in planning the production process in a manufacturing company.

Like PowerSki, every organization—whether it produces goods or provides services—sees Job 1 as furnishing customers with quality products. Thus, to compete with other organizations, a company must convert resources (materials, labor, money, information) into goods or services as efficiently as possible. The upper-level manager who directs this transformation process is called an *operations manager*. The job of operations management (OM), then, consists of all the activities involved in transforming a product idea into a finished product, as well as those involved in planning and controlling the systems that produce goods and services. In other words, operations managers manage the process that transforms inputs into outputs. Figure 11.1 “The Transformation Process” illustrates this traditional function of operations management.

Figure 11.1 The Transformation Process



In the rest of this chapter, we'll discuss the major activities of operations managers. We'll start by describing the role that operations managers play in the various processes designed to produce goods and offer services. Next, we'll look at the production of goods in manufacturing firms; then, we'll describe operations management activities in companies that provide services. We'll wrap up the chapter by explaining the role of operations management in such processes as quality control and outsourcing.

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11.2: Facility Layouts

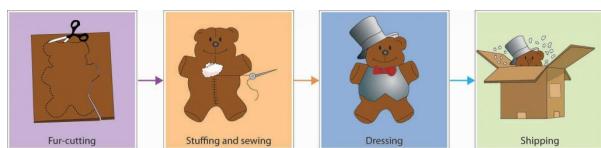
Learning Objective

1. Describe four major types of facility layouts: process, product, cellular, and fixed position.

The next step in production planning is deciding on plant layout—how equipment, machinery, and people will be arranged to make the production process as efficient as possible. In this section, we'll examine four common types of facility layouts: process, product, cellular, and fixed position.

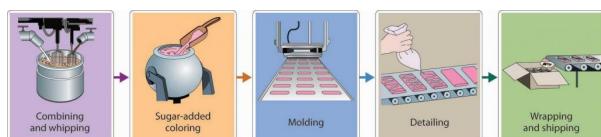
The process layout groups together workers or departments that perform similar tasks. *Goods in process* (goods not yet finished) move from one workstation to another. At each position, workers use specialized equipment to perform a particular step in the production process. To better understand how this layout works, we'll look at the production process at the Vermont Teddy Bear Company. Let's say that you just placed an order for a personalized teddy bear—a “hiker bear” with khaki shorts, a white T-shirt with your name embroidered on it, faux-leather hiking boots, and a nylon backpack with sleeping bag. Your bear begins at the fur-cutting workstation, where its honey-brown “fur” coat is cut. It then moves to the stuffing and sewing workstation to get its insides and have its sides stitched together. Next, it moves to the dressing station, where it's outfitted with all the cool clothes and gear that you ordered. Finally, it winds up in the shipping station and starts its journey to your house. For a more colorful “Online Mini-Tour” of this process, log on to the Vermont Teddy Bear Web site at www.vermontteddybear.com/Stat...mestation.aspx (or see Figure 11.3 “Process Layout at Vermont Teddy Bear Company”).

Figure 11.3 Process Layout at Vermont Teddy Bear Company



In a product layout, high-volume goods are produced efficiently by people, equipment, or departments arranged in an *assembly line*—that is, a series of workstations at which already-made parts are *assembled*. Just Born, a candy maker located in Bethlehem, Pennsylvania, makes a product called Marshmallow Peeps on an assembly line. First, the ingredients are combined and whipped in huge kettles. Then, sugar is added for color. At the next workstation, the mixture—colored warm marshmallow—is poured into baby-chick-shaped molds carried on conveyor belts. The conveyor-belt parade of candy pieces then moves forward to stations where workers add eyes or other details. When the finished candy reaches the packaging area, it's wrapped for shipment to stores around the world. To take an online tour of the Marshmallow Peeps production process, log on to the Just Born Web site at www.justborn.com/get-to-know-us/our-factory (or see Figure 11.4 “Product Layout at Just Born, Inc.”).

Figure 11.4 Product Layout at Just Born, Inc.

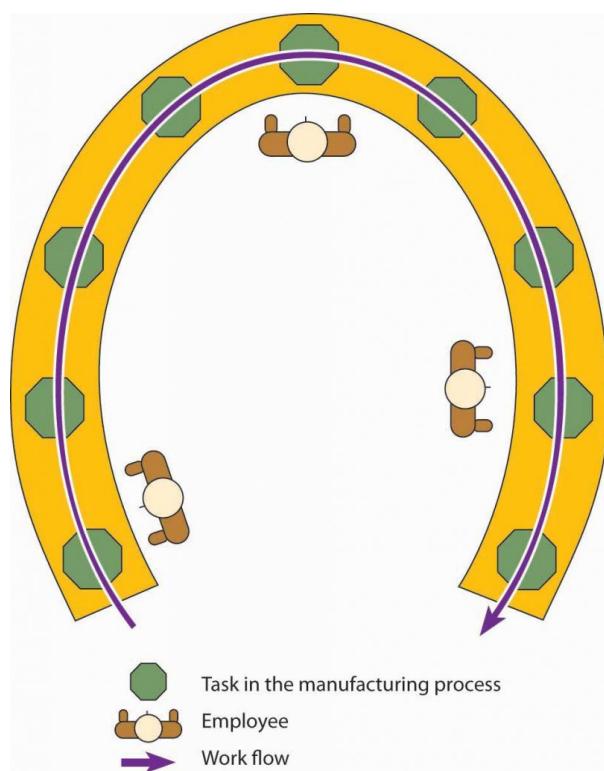


Both product and process layouts arrange work by *function*. At the Vermont Teddy Bear Company, for example, the cutting function is performed in one place, the stuffing-and-sewing function in another place, and the dressing function in a third place. If you're a cutter, you cut all day; if you're a sewer, you sew all day: that's your function. The same is true for the production of Marshmallow Peeps at Just Born: if your function is to decorate peeps, you stand on an assembly line and decorate all day; if your function is packing, you pack all day.

Arranging work by function, however, isn't always efficient. Production lines can back up, inventories can build up, workers can get bored with repetitive jobs, and time can be wasted in transporting goods from one workstation to another. To counter some of these problems, many manufacturers have adopted a cellular layout, in which small teams of workers handle all aspects of building a component, a “family” of components, or even a finished product. Each team works in a small area, or cell, equipped with everything that it needs to function as a self-contained unit. Machines are sometimes configured in a U-shape, with people working inside the U. Because team members often share duties, they're trained to perform several different jobs. Teams monitor both the quantity and the quality of their own output. This arrangement often results in faster completion time, lower inventory levels,

improved quality, and better employee morale. Cellular manufacturing is used by large manufacturers, such as Boeing, Raytheon, and Pratt & Whitney (Chaneski, 1998), as well as by small companies, such as Little Enterprise, which makes components for robots (Modern Machine Shop Magazine, 2001; Little Enterprises, Inc., 2011). Figure 11.5 “Cellular Layout” illustrates a typical cellular layout.

Figure 11.5 Cellular Layout



It's easy to move teddy bears and marshmallow candies around the factory while you're making them, but what about airplanes or ships? In producing large items, manufacturers use fixed-position layout in which the product stays in one place and the workers (and equipment) go to the product. This is the arrangement used by General Housing Corporation in constructing modular homes. Each house is constructed at the company's factory in Bay City, Michigan, according to the customer's design. Because carpenters, electricians, plumbers, and others work on each building inside the climate-controlled factory, the process can't be hindered by weather. Once it's done, the house is transported in modules to the owner's building site and set up in one day. For a closer view of General Housing Corporation's production process, go to the General Housing Web site at <http://www.genhouse.com>.

Key Takeaways

- Managers have several production **layout** choices, including process, product, cellular, and fixed-position.
- The **process layout** groups together workers or departments that perform similar tasks. At each position, workers use specialized equipment to perform a particular step in the production process.
- In a **product layout**, high-volume goods are produced in assembly-line fashion—that is, a series of workstations at which already-made parts are assembled.
- In a **cellular layout**, small teams of workers handle all aspects of building a component, a “family of components,” or even a finished product.
- A **fixed-position layout** is used to make large items (such as ships or buildings) that stay in one place while workers and equipment go to the product.

Exercise

(AACSB) Analysis

As purchasing manager for a company that flies corporate executives around the world, you're responsible for buying everything from airplanes to onboard snacks. You plan to visit all the plants that make the things you buy: airplanes, passenger seats, TV/DVDs that go in the back of the passenger seats, and the specially designed uniforms (with embroidered company logos) worn

by the flight attendants. What type of layout should you expect to find at each facility—process, product, or fixed-position? What will each layout look like? Why is it appropriate for the company's production process? Could any of these plants switch to a cellular layout? What would this type of layout look like? What would be its advantages?

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11.3: Managing the Production Process in a Manufacturing Company

Learning Objective

1. Identify the activities undertaken by the operations manager in overseeing the production process in a manufacturing company.

Once the production process is in place, the attention of the operations manager shifts to the daily activities of materials management, which encompass the following activities: purchasing, inventory control, and work scheduling.

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11.4: Graphical Tools- PERT and Gantt Charts

Learning Objective

1. Explain how to create and use both PERT and Gantt charts.

Because they also need to control the timing of all operations, managers set up *schedules*: They select jobs to be performed during the production process, assign tasks to work groups, set timetables for the completion of tasks, and make sure that resources will be available when and where they're needed. There are a number of scheduling techniques. We'll focus on two of the most common—*Gantt* and *PERT* charts.

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11.5: The Technology of Goods Production

Learning Objective

1. Explain how manufacturing companies use technology to produce and deliver goods in an efficient, cost-effective manner.

PowerSki founder and CEO Bob Montgomery spent sixteen years designing the Jetboard and bringing it to production. At one point, in his efforts to get the design just right, he'd constructed thirty different prototypes. Needless to say, this process took a very long time, but even so, Montgomery thought that he could handle the designing of the engine without the aid of a computer. Before long, however, he realized that it was impossible to keep track of all the changes.

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11.6: Operations Management for Service Providers

Learning Objectives

1. List the characteristics that distinguish service operations from manufacturing operations.
2. Describe the decisions made in planning the product delivery process in a service company.
3. Identify the activities undertaken to manage operations in a service organization.

As the U.S. economy has changed from a goods producer to a service provider, the predominance of the manufacturing sector has declined substantially over the last sixty years. Today, only about 9 percent of U.S. workers are employed in manufacturing, in contrast to 30 percent in 1950 (The Global Language Monitor, 2010; Strauss, 2010). Most of us now hold jobs in the service sector, which accounts for 77 percent of U.S. gross domestic product (International Monetary Fund, 2010; Wikipedia, 2011). Wal-Mart is now America's largest employer, followed by IBM, United Parcel Service (UPS), McDonald's, and Target. Not until we drop down to the seventh-largest employer—Hewlett Packard—do we find a company with even a manufacturing component (24/7 Wall Street, 2011).

Figure 11.9



Wal-Mart employs more than a million people in the United States.

Mike Mozart – [Walmart](#) – CC BY 2.0.

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11.7: Producing for Quality

Learning Objective

1. Explain how manufacturing and service companies alike use total quality management and outsourcing to provide value to customers.

What do you do if you get it home and your brand-new DVD player doesn't work? What if you were late for class because it took you twenty minutes to get a burger and order of fries at the drive-through window of a fast-food restaurant? Like most people, you'd probably be more or less disgruntled. As a customer, you're constantly assured that when products make it to market, they're of the highest possible quality, and you tend to avoid brands that have failed to live up to your expectations or to producers' claims. You're told that workers in such businesses as restaurants are there to serve you, and you probably don't go back to establishments where you've received poor-quality service.

But what is *quality*? According to the American Society for Quality, quality refers to "the characteristics of a product or service that bear on its ability to satisfy stated or implied needs" (American Society of Quality, 2011). When you buy a DVD player, you expect it to play DVDs. When it doesn't, you question its quality. When you go to a drive-through window, you expect to be served in a reasonable amount of time. If you're forced to wait, you conclude that you're the victim of poor-quality service.

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11.8: Cases and Problems

Learning on the Web (AACSB)

How to Build a BMW

How'd you like to own a Series 3 BMW? How about a convertible priced at \$48,000 for those warm summer days? Or maybe a less expensive coupe for \$39,000? Or, if you need more space for hauling camping equipment, dogs, or kids, maybe you would prefer a wagon at \$37,000? We can't help you finance a BMW, but we can show you how they're made. Go to <http://www.bmw-plant-munich.com/> to link to the BMW Web site for a virtual tour of the company's Munich, Germany, plant.

First, click on "Location" and then on "The Plant in Figures." Before going any further, answer the following questions:

1. How many associates (employees) work in the plant?
2. How many apprentices (trainees) work there? Why does the plant have trainees?
3. How many cars are made in the plant each day? How many engines?

Next, click on "Production" to open a drop-down list that looks like this:

Fascination Production
Press Shop
Body Shop
Paint Shop
Engine Assembly
Assembly

Click on "Fascination Production," and watch a video that zips you through the production steps needed to make a BMW. Continue your tour by clicking on each progressive step taken to build a quality car: press shop, body shop, paint shop, engine assembly and final assembly. After reading about and watching the brief video describing the work done in a particular area of the plant, pause and answer the following questions (you will answer this set of questions five times—once for each of these areas of the factory: press shop, body shop, paint shop, engine assembly, and final assembly):

1. What production steps occurred in this area of the plant?
2. What technology does BMW use in the production process?
3. Approximately what percentage of the work was done by people?
4. What procedures were followed to ensure the production of high-quality vehicles?

Career Opportunities

Wanted: Problem Solvers and Creative Thinkers

If you had a time machine plus a craving for a great hamburger, you could return to the early 1950s and swing by Dick and Mac McDonald's burger stand in San Bernardino, California. Take a break from eating and watch the people in the kitchen. You'll see an early application of operations management in the burger industry. Dick and Mac, in an effort to sell more burgers in less time, redesigned their kitchen to use assembly-line procedures. As the number of happy customers grew, word spread about their speedy system, and their business thrived. Curiously, it wasn't Dick and Mac who made McDonald's what it is today, but rather a traveling milkshake-mixer salesman named Ray Kroc. He visited the hamburger stand to learn how they could sell twenty thousand shakes a year. When he saw their operations and the lines of people walking away with bags filled with burgers, fries, and shakes, he knew he had a winner. In cooperation with the McDonald brothers, he started selling franchises around the country, and the rest is history.

So, what does this story have to do with a career in operations management? If you're a problem solver like Dick and Mac (who discovered a way to make burgers faster and cheaper) or a creative thinker like Ray Kroc (who recognized the value in an assembly-line burger production system), then a career in operations management might be for you. The field is broad and offers a variety of opportunities. To get a flavor of the choices available, go to www.wetfeet.com/Careers-and-I...perations.aspx to link to the WetFeet Web site and review the dozen or so operations management positions listed. Provide a brief description of each position. Indicate how interesting you find each position by rating it using a five-point scale (with 1 being uninteresting and 5 being

very interesting). Based on your assessment, pick the position you find most interesting and the one you find least interesting. Explain why you made your selections.

Ethics Angle (AACSB)

In many ways, Eastman Kodak (a multinational manufacturer and distributor of photographic equipment and supplies) is a model corporate citizen. *Fortune* magazine has ranked it as one of the country's most admired companies, applauding it in particular for its treatment of minorities and women. Its community-affairs programs and contributions have also received praise, but Eastman Kodak remains weak in one important aspect of corporate responsibility: it has consistently received low scores on environmental practices. For example, the watchdog group Scorecard rated Eastman Kodak's Rochester, New York, facility as the third-worst emitter of airborne carcinogens in the United States. Other reports have criticized the company for dumping cancer-causing chemicals into the nation's waters.

Go to www.kodak.com/US/en/corp/HSE/homepage.jhtml?pd-path=2879/7196 to link to the Eastman Kodak Web site and read its own assessment of its environmental practices. Then answer the following questions:

- Based on the information provided on its Web site, how favorable do you feel about Eastman Kodak's environmental practices?
- In what ways is the company responding to criticisms of its environmental practices and improving them?
- Do the statements on the Web site mesh with the criticism that the company has received? If not, what accounts for the differences?

Team-Building Skills (AACSB)

Growing Accustomed to Your Fit

Instead of going to the store to try on several pairs of jeans that may or may not fit, wouldn't it be easier to go online and order a pair of perfect-fitting jeans? Lands' End has made this kind of shopping possible through mass-customization techniques and some sophisticated technology.

To gain some firsthand experience at shopping for mass-customized goods, have each member of your team go to Nike's iD site at <http://nikeid.nike.com>. Each team member should go through the process of customizing a different Nike product but stop right before placing an order. After everyone has gone through the process, get together and write a report in which the team explains exactly what's entailed by online mass customization and details the process at Nike. Be sure to say which things impressed you and which didn't. Explain why Nike developed this means of marketing products and, finally, offer some suggestions on how the process could be improved.

The Global View (AACSB)

What's the State of Homeland Job Security?

Over the past several decades, more and more U.S. manufacturers began outsourcing production to such low-wage countries as Mexico and China. The number of U.S. manufacturing jobs dwindled, and the United States became more of a service economy. People who were directly affected were understandably unhappy about this turn of events, but most people in this country didn't feel threatened. At least, not until service jobs also started going to countries that, like India, have large populations of well-educated, English-speaking professionals. Today, more technology-oriented jobs, including those in programming and Internet communications, are being outsourced to countries with lower wage rates. And tech workers aren't alone: the jobs of accountants, analysts, bankers, medical technicians, paralegals, insurance adjusters, and even customer-service representatives have become candidates for overseas outsourcing.

Many U.S. workers are concerned about job security (though the likelihood of a particular individual's losing a job to an overseas worker is still fairly low). The issues are more complex than merely deciding where U.S. employers should be mailing paychecks, and politicians, economists, business executives, and the general public differ about the causes and consequences of foreign outsourcing. Some people think it's a threat to American quality of life, while others actually think that it's a good thing.

Spend some time researching trends in outsourcing. Formulate some opinions, and then answer the following questions:

1. About what percentage of U.S. jobs have left the country in the last five years? What percentage will probably leave in the next five years?
2. What kinds of jobs are being outsourced, and where are they going? What kinds of jobs can't be outsourced?
3. How does global outsourcing help U.S. businesses? How does it hinder them?

4. How has the trend in outsourcing manufacturing and service operations to foreign countries helped average Americans? How has it harmed them?
5. Does overseas outsourcing help or hurt the U.S. economy? In what ways?

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CHAPTER OVERVIEW

12: The Role of Accounting in Business

- 12.1: The Role of Accounting
- 12.2: Understanding Financial Statements
- 12.3: Accrual Accounting
- 12.4: Financial Statement Analysis
- 12.5: The Profession- Ethics and Opportunities
- 12.6: Cases and Problems

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12.1: The Role of Accounting

Learning Objectives

1. Define *accounting* and explain the differences between *managerial accounting* and *financial accounting*.
2. Identify some of the users of accounting information and explain how they use it.

Accounting is often called “the language of business.” Why? Because it *communicates* so much of the information that owners, managers, and investors need to evaluate a company’s financial performance. These people are all stakeholders in the business—they’re interested in its activities because they’re affected by them. In fact, the purpose of accounting is to help stakeholders make better business decisions by providing them with financial information. Obviously, you wouldn’t try to run an organization or make investment decisions without accurate and timely financial information, and it’s the accountant who prepares this information. More importantly, accountants make sure that stakeholders understand the *meaning* of financial information, and they work with both individuals and organizations to help them use financial information to deal with business problems. Actually, collecting all the numbers is the easy part—today, all you have to do is start up your accounting software. The hard part is analyzing, interpreting, and communicating the information. Of course, you also have to present everything clearly while effectively interacting with people from every business discipline. In any case, we’re now ready to define accounting as the process of measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.

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12.2: Understanding Financial Statements

Learning Objectives

1. Understand the function of the *income statement*.
2. Understand the function of the *balance sheet*.
3. Understand the function of the *statement of owner's equity*.

We hope that, so far, we've made at least one thing clear: If you're in business, you need to understand financial statements. For one thing, the law no longer allows high-ranking executives to plead ignorance or fall back on delegation of authority when it comes to taking responsibility for a firm's financial reporting. In a business environment tainted by episodes of fraudulent financial reporting and other corporate misdeeds, top managers are now being held accountable (so to speak) for the financial statements issued by the people who report to them. For another thing, top managers need to know if the company is hitting on all cylinders or sputtering down the road to bankruptcy. To put it another way (and to switch metaphors): if he didn't understand the financial statements issued by the company's accountants, an executive would be like an airplane pilot who doesn't know how to read the instrument in the cockpit—he might be able keep the plane in the air for a while, but he wouldn't recognize any signs of impending trouble until it was too late.

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12.3: Accrual Accounting

Learning Objectives

1. Understand the difference between *cash-basis* and *accrual accounting*.
2. Understand the purpose of a *statement of cash flows* and describe its format.

In this section, we're going to take a step further into the world of accounting by examining the principles of *accrual accounting*. In our Stress-Buster illustration, we've assumed that all your transactions have been made in *cash*: You paid cash for your inputs (plastic treasure chests and toys) and for your other expenses, and your customers paid cash when they bought Stress-Buster packs. In the real world, of course, things are rarely that simple. In the following cases, timing plays a role in making and receiving payments:

- Customers don't always pay in cash; they often buy something and pay later. When this happens, the seller is owed money and has an account receivable (it will *receive* something later).
- Companies don't generally pay cash for materials and other expenses—they often pay later. If this is the case, the buyer has an account payable (it will *pay* something later).
- Many companies manufacture or buy goods and hold them in inventory before selling them. Under these circumstances, they don't report payment for the goods until they've been sold.
- Companies buy *long-term assets* (also called *fixed assets*), such as cars, buildings, and equipment, which they plan to use over an extended period (as a rule, for more than one year).

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12.4: Financial Statement Analysis

Learning Objective

1. Evaluate a company's performance using financial statements and ratio analysis.

Now that you know how financial statements are prepared, let's see how they're used to help owners, managers, investors, and creditors assess a firm's performance and financial strength. You can glean a wealth of information from financial statements, but first you need to learn a few basic principles for "unlocking" it.

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12.5: The Profession- Ethics and Opportunities

Learning Objectives

1. Understand why it's not a good idea to falsify financial statements.
2. Appreciate the background behind stricter legal and professional standards in U.S. business and accounting practice.
3. Understand *ethics* and their importance in the accounting profession.
4. Identify career opportunities in accounting.

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12.6: Cases and Problems

Learning on the Web (AACSB)

Discounting Retailers

There was a time when Kmart was America's number-one discount retailer and Sears, Roebuck & Co. was the seventh largest corporation in the world. Things have changed since Wal-Mart came on the scene. In the fifty years since Sam Walton opened the first Wal-Mart store in Rogers, Arkansas, the company has propelled itself to the number-one spot in discount retailing, and (even more impressive) has higher sales than *any other company in the world*. Over this same fifty-year period, Target emerged as a major player in the retail industry. The fifty-year period wasn't kind to Kmart and Sears, and both stores watched their dominance in the retail market slip away. In an effort to reverse the downward spiral of both retailers, in November 2004, Sears and Kmart merged into a new company called Sears Holdings. To learn more about how Wal-Mart, Target, and Sears Holdings are doing today, go to the National Retail Federation's Web site (<http://www.stores.org/STORES%20Magaz...-100-retailers>) to access a report that ranks the 2010 top 100 retailers. After reading the introduction and reviewing the list of top retailers, prepare a report comparing the three retailers on the following:

- U.S. sales and percentage increase or decrease in sales
- Worldwide sales
- Number of stores and percentage increase or decrease in number of stores

Based on your analysis and reading of the introductory write-up, answer the following questions:

1. Do you believe that Target will be able to compete against Wal-Mart in the future? If so, how?
2. What about Sears Holdings? Will the company survive?
3. Some people criticize Wal-Mart for forcing other retailers out of business and for lowering the average wage for retail workers. Is this a legitimate criticism? In your opinion, has Wal-Mart helped the American people or hurt them?

Career Opportunities

Is a Career in Accounting for You?

Do you want to learn what opportunities are available for people graduating with degrees in accounting? Go to the Web site of the American Institute of Certified Public Accountants (<http://www.starthereregplaces.com>) and click on "Why Accounting?" (top, left). Then click on "Career Options" (left side bar). Select two areas of interest. Click on each interest area and select a job in that area that interests you. For each of two jobs selected (one from each interest area), answer the following questions:

- What is the job like?
- Why does the job seem interesting to you?

Ethics Angle (AACSB)

Counting Earnings before They Hatch

You recently ran into one of your former high school teachers. You were surprised to learn that he'd left teaching, gone back to school, and, a little more than a year ago, started a business that creates Web sites for small companies. It so happens that he needs a loan to expand his business, and the bank wants financial statements. When he found out that you were studying accounting, he asked whether you'd look over a set of statements that he'd just prepared for his first year in business. Because you're anxious to show off your accounting aptitude, you agreed.

First, he showed you his income statement. It looked fine: revenues (from designing Web sites) were \$94,000, expenses were \$86,000, and net income was \$8,000. When you observed how unusual it was that he'd earned a profit in his first year, he seemed a little uneasy.

"Well," he confessed, "I fudged a little when I prepared the statements. Otherwise, I'd never get the loan."

He admitted that \$10,000 of the fees shown on the income statement was for work he'd recently started doing for a client (who happened to be in big trouble with the IRS). "It isn't like I won't be earning the money," he explained. "I'm just counting it a little early. It was easy to do. I just added \$10,000 to my revenues and recorded an accounts receivable for the same amount."

You quickly did the math: without the \$10,000 payment for the client in question, his profit of \$8,000 would become a loss of \$2,000 (revenues of \$84,000 less expenses of \$86,000).

As your former teacher turned to get his balance sheet, you realized that, as his accountant, you had to decide what you'd advise him to do. The decision is troublesome because you agree that if he changes the income statement to reflect the real situation, he won't get the bank loan.

1. What did you decide to do, and why?
2. Assuming that he doesn't change the income statement, will his balance sheet be incorrect? How about his statement of cash flows? What will happen to next year's income: will it be higher or lower than it should be?
3. What would happen to your former teacher if he gave the bank the fraudulent financial statements and the bank discovered the truth? How could the bank learn the truth?

Team-Building Skills (AACSB)

Taking Stock of Ratios

Your class has been told that each group of three students will receive a share of stock in one of three companies in the same industry. But there's a catch: each group has to decide which of the companies it wants to own stock in. To reach this decision, your team will use ratio analysis to compare the three companies. Each team member will analyze one of the companies using the ratios presented in this chapter. Then, you'll get together, compare your results, and choose a company. Here are the details of the project:

1. The team selects a group of three companies in the same industry. Here are just a few examples:
 - *Auto manufacturers.* Ford, General Motors, Toyota
 - *Airlines.* Southwest, United Airlines, American Airlines
 - *Drug companies.* GlaxoSmithKline, Eli Lilly & Co., Bristol-Myers Squibb
 - *Specialty retailers.* Bed Bath & Beyond, Pottery Barn, Pier 1 Imports
 - *Computers.* Hewlett Packard, Gateway, Apple Computer
2. Every team member gets a copy of one company's most recent annual report (which includes its financial statements) from the company's Web site (investor section).
3. Every member calculates the following ratios for the company for the last two years: gross profit margin, net profit margin, inventory turnover (if applicable), return on assets, current ratio, debt-to-equity, and interest coverage.
4. Get together as a group and compare your results. Decide as a group which company you want to own stock in.
5. Write a report indicating the company that your team selected and explain your choice. Attach the following items to your team report:

The Global View (AACSB)

Why Aren't Shoes Made in the USA?

Having just paid \$70 for a pair of athletic shoes that were made in China, you wonder why they had to be made in that country. Why weren't they made in the United States, where lots of people need good-paying jobs? You also figure that the shoe company must be making a huge profit on each pair it sells. Fortunately, you were able to get a breakdown of the costs for making a pair of \$70 athletic shoes (Canderbilt, 1998):

Production labor	\$2.75
Materials	9.00
Rent, equipment	3.00
Supplier's operating profit	1.75
Duties	3.00
Shipping	0.50
Cost to the Manufacturer	\$20.00
Research and development	0.25
Promotion and advertising	4.00
Sales, distribution, administration	5.00

Shoe company's operating profit	6.25
Cost to the Retailer	\$35.50
Retailer's Rent	9.00
Personnel	9.50
Other	7.00
Retailer's operating profit	9.00
Cost to Consumer	\$70.00

You're surprised at a few of these items. First, out of the \$70, the profit made by the manufacturer was only \$6.25. Second, at \$2.75, labor accounted for only about 4 percent of the price you paid. The advertising cost (\$4.00) was higher than the labor cost. If labor isn't a very big factor in the cost of the shoes, why are they made in China?

Deciding to look further into this puzzle, you discover that the \$2.75 labor cost was for two hours of work. Moreover, that \$2.75 includes not only the wages paid to the workers, but also labor-related costs, such as food, housing, and medical care.

That's when you begin to wonder. How much would I have to pay for the same shoes if they were made in the United States? Or what if they were made in Mexico? How about Spain? To answer these questions, you need to know the hourly wage rates in these countries. Fortunately, you can get this information by going to the Foreign Labor section of the Bureau of Labor Statistics Web site (<http://www.bls.gov/news.release/ichcc.t08.htm>). The table you want is "Production Workers: Hourly Compensation Costs in U.S. Dollars." Use the most recent hourly compensation figures.

To investigate this issue further, you should do the following:

1. Recalculate the cost of producing the shoes in the United States and two other countries of your choice. Because operating profit for the supplier, the shoe company, and the retailer will change as the cost to make the shoe changes, you have decided to determine this profit using the following percentage rates:

- Supplier's operating profit: 10 percent of its costs
- Shoe company's operating profit: 20 percent of its costs (including the cost paid to the supplier to make the shoes)
- Retailer's operating profit: 15 percent of its costs (including the cost paid to the shoe company)

2. Prepare a report that does the following:

- Shows the selling price of the shoe for each manufacturing country (the United States and the other two countries you selected)
- Lists any costs other than labor that might change if shoe production was moved to the United States
- Identifies other factors that should be considered when selecting a manufacturing country
- Indicates possible changes to production methods that would make production in the United States less costly

3. Finally, draw some conclusions: Do you, as a U.S. citizen, benefit from shoe production in foreign countries? Does the United States benefit overall? Does the world benefit? Should shoe production return to the United States?

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CHAPTER OVERVIEW

13: Managing Financial Resources

- 13.1: The Functions of Money
- 13.2: Financial Institutions
- 13.3: The Federal Reserve System
- 13.4: The Role of the Financial Manager
- 13.5: Understanding Securities Markets
- 13.6: Financing the Going Concern
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13.1: The Functions of Money

Learning Objective

1. Identify the functions of money and describe the three government measures of the money supply.

Finance is about money. So our first question is, what is money? If you happen to have one on you, take a look at a \$5 bill. What you'll see is a piece of paper with a picture of Abraham Lincoln on one side and the Lincoln Memorial on the other. Though this piece of paper—indeed, money itself—has no intrinsic value, it's certainly in demand. Why? Because money serves three basic functions. Money is the following:

1. A medium of exchange
2. A measure of value
3. A store of value



Figure 13.1. Money itself has no intrinsic value. 401(K) 2012 – Money – CC BY-SA 2.0.

To get a better idea of the role of money in a modern economy, let's imagine a system in which there is no money. In this system, goods and services are *bartered*—traded directly for one another. Now, if you're living and trading under such a system, for each barter exchange that you make, you'll have to have something that another trader wants. For example, say you're a farmer who needs help clearing his fields. Because you have plenty of food, you might enter into a barter transaction with a laborer who has time to clear fields but not enough food: he'll clear your fields in return for three square meals a day.

This system will work as long as two people have exchangeable assets, but needless to say, it can be inefficient. If we identify the functions of money, we'll see how it improves the exchange for all the parties in our hypothetical set of transactions.

Medium of Exchange

Money serves as a medium of exchange because people will accept it in exchange for goods and services. Because people can use money to buy the goods and services that they want, everyone's willing to trade something for money. The laborer will take money for clearing your fields because he can use it to buy food. You'll take money as payment for his food because you can use it not only to pay him but also to buy something else you need (perhaps seeds for planting crops).

For money to be used in this way, it must possess a few crucial properties:

1. It must be *divisible*—easily divided into usable quantities or fractions. A \$5 bill, for example, is equal to five \$1 bills. If something costs \$3, you don't have to rip up a \$5 bill; you can pay with three \$1 bills.
2. It must be *portable*—easy to carry; it can't be too heavy or bulky.
3. It must be *durable*. It must be strong enough to resist tearing and the print can't wash off if it winds up in the washing machine.

4. It must be *difficult to counterfeit*; it won't have much value if people can make their own.

Measure of Value

Money simplifies exchanges because it serves as a measure of value. We state the price of a good or service in monetary units so that potential exchange partners know exactly how much value we want in return for it. This practice is a lot better than bartering because it's much more precise than an ad hoc agreement that a day's work in the field has the same value as three meals.

Store of Value

Money serves as a store of value. Because people are confident that money keeps its value over time, they're willing to save it for future exchanges. Under a bartering arrangement, the laborer earned three meals a day in exchange for his work. But what if, on a given day, he skipped a meal? Could he "save" that meal for another day? Maybe, but if he were paid in money, he could decide whether to spend it on food each day or save some of it for the future. If he wanted to collect on his "unpaid" meal two or three days later, the farmer might not be able to "pay" it; unlike money, food could go bad.

The Money Supply

Now that we know what money does, let's tackle another question: How much money is there? How would you go about "counting" all the money held by individuals, businesses, and government agencies in this country? You could start by counting the money that's held to pay for things on a daily basis. This category includes *cash* (paper bills and coins) and funds held in **demand deposits**—checking accounts, which pay given sums to "payees" when they demand them.

Then, you might count the money that's being "saved" for future use. This category includes *interest-bearing accounts*, *time deposits* (such as *certificates of deposit*, which pay interest after a designated period of time), and **money market mutual funds**, which pay interest to investors who pool funds to make short-term loans to businesses and the government.

M-1 and M-2

Counting all this money would be a daunting task (in fact, it would be impossible). Fortunately, there's an easier way—namely, by examining two measures that the government compiles for the purpose of tracking the money supply: M-1 and M-2.

- The narrowest measure, **M-1**, includes the most *liquid* forms of money—the forms, such as cash and checking-accounts funds, that are spent immediately.
- **M-2** includes everything in M-1 plus *near-cash items* invested for the short term—savings accounts, time deposits below \$100,000, and money market mutual funds.

So what's the bottom line? How much money is out there? To find the answer, you can go to the Federal Reserve Board Web site. The Federal Reserve reports that in September 2011, M-1 was about \$2.1 trillion and M-2 was \$9.6 trillion (Federal Reserve, 2011). [Figure 13.2 "The U.S. Money Supply, 1980–2010"](#) shows the increase in the two money-supply measures since 1980.

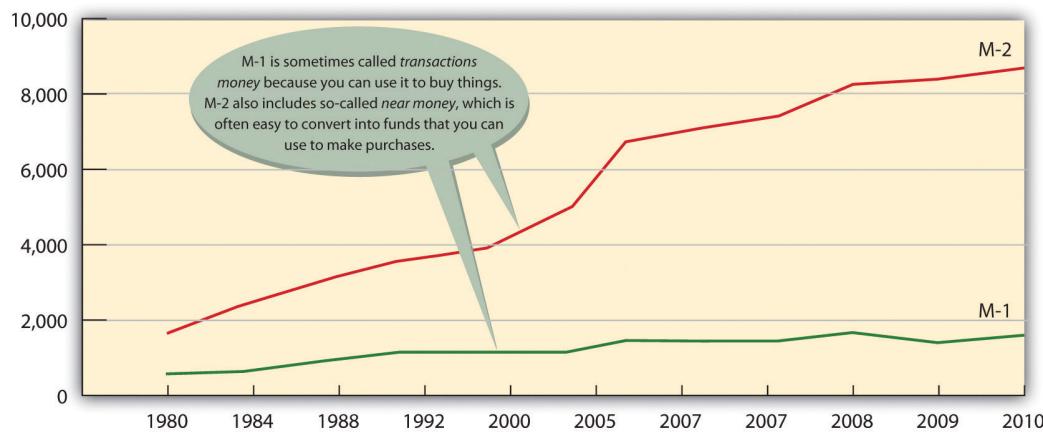


Figure 13.2. The U.S. Money Supply, 1980–2010

If you're thinking that these numbers are too big to make much sense, you're not alone. One way to bring them into perspective is to figure out how much money *you'd* get if all the money in the United States were redistributed equally. According to the U.S.

Census Population Clock (U.S. Census Bureau, 2011), there are more than three hundred million people in the United States. Your share of M-1, therefore, would be about \$6,700 and your share of M-2 would be about \$31,000.

What, Exactly, Is “Plastic Money”?

Are credit cards a form of money? If not, why do we call them plastic money? Actually, when you buy something with a credit card, you’re not spending money. The principle of the credit card is buy-now-pay-later. In other words, when you use plastic, you’re taking out a loan that you intend to pay off when you get your bill. And the loan itself is not money. Why not? Basically because the credit card company can’t use the asset to buy anything. The loan is merely a promise of repayment. The asset doesn’t become money until the bill is paid (with interest). That’s why credit cards aren’t included in the calculation of M-1 and M-2.

Key Takeaways

- Money serves three basic functions:
 1. *Medium of exchange*: because you can use it to buy the goods and services you want, everyone’s willing to trade things for money.
 2. *Measure of value*: it simplifies the exchange process because it’s a means of indicating how much something costs.
 3. *Store of value*: people are willing to hold onto it because they’re confident that it will keep its value over time.
- The government uses two measures to track the money supply: **M-1** includes the most liquid forms of money, such as cash and checking-account funds. **M-2** includes everything in M-1 plus near-cash items, such as savings accounts and time deposits below \$100,000.

Exercise

(AACSB) Analysis

Instead of coins jingling in your pocket, how would you like to have a pocketful of cowrie shells? These smooth, shiny snail shells, which are abundant in the Indian Ocean, have been used for currency for more than four thousand years. At one point, they were the most widely used currency in the world. Search “cowrie shells” on Google and learn as much as you can about them. Then answer the following questions:

1. How effectively did they serve as a medium of exchange in ancient times?
2. What characteristics made them similar to today’s currencies?
3. How effective would they be as a medium of exchange today?

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13.2: Financial Institutions

Learning Objectives

1. Distinguish among different types of financial institutions.
2. Discuss the services that financial institutions provide and explain their role in expanding the money supply.

For financial transactions to happen, money must change hands. How do such exchanges occur? At any given point in time, some individuals, businesses, and government agencies have more money than they need for current activities; some have less than they need. Thus, we need a mechanism to match up savers (those with surplus money that they're willing to lend out) with borrowers (those with deficits who want to borrow money). We could just let borrowers search out savers and negotiate loans, but the system would be both inefficient and risky. Even if you had a few extra dollars, would you lend money to a total stranger? If you needed money, would you want to walk around town looking for someone with a little to spare?

Depository and Nondepository Institutions

Now you know why we have financial institutions: they act as intermediaries between savers and borrowers and they direct the flow of funds between them. With funds deposited by savers in checking, savings, and money market accounts, they make loans to individual and commercial borrowers. In the next section, we'll discuss the most common types of depository institutions (banks that accept deposits), including *commercial banks*, *savings banks*, and *credit unions*. We'll also discuss several nondepository institutions (which provide financial services but don't accept deposits), including finance companies, insurance companies, brokerage firms, and pension funds.

Commercial Banks

Commercial banks are the most common financial institutions in the United States, with total financial assets of about \$13.5 trillion (85 percent of the total assets of the banking institutions) (Insurance Information Institute, 2011). They generate profit not only by charging borrowers higher interest rates than they pay to savers but also by providing such services as check processing, trust- and retirement-account management, and electronic banking. The country's 7,000 commercial banks range in size from very large (Bank of America, J.P. Morgan Chase) to very small (local community banks). Because of mergers and financial problems, the number of banks has declined significantly in recent years, but, by the same token, surviving banks have grown quite large. If you've been with one bank over the past ten years or so, you've probably seen the name change at least once or twice.

Savings Banks

Savings banks (also called *thrift institutions* and *savings and loan associations*, or *S&Ls*) were originally set up to encourage personal saving and provide mortgages to local home buyers. Today, however, they provide a range of services similar to those offered by commercial banks. Though not as dominant as commercial banks, they're an important component of the industry, holding total financial assets of almost \$1.5 trillion (10 percent of the total assets of the banking institutions) (Insurance Information Institute, 2010). The largest S&L, Sovereign Bancorp, has close to 750 branches in nine Northeastern states. Savings banks can be owned by their depositors (mutual ownership) or by shareholders (stock ownership).

Credit Unions

To bank at a **credit union**, you must be linked to a particular group, such as employees of United Airlines, employees of the state of North Carolina, teachers in Pasadena, California, or current and former members of the U.S. Navy. Credit unions are owned by their members, who receive shares of their profits. They offer almost anything that a commercial bank or savings and loan does, including savings accounts, checking accounts, home and car loans, credit cards, and even some commercial loans (Pennsylvania Association of Community Bankers, 2011). Collectively, they hold about \$812 billion in financial assets (around 5 percent of the total assets of the financial institutions).

[Figure 13.3 “Where Our Money Is Deposited”](#) summarizes the distribution of assets among the nation's depository institutions.

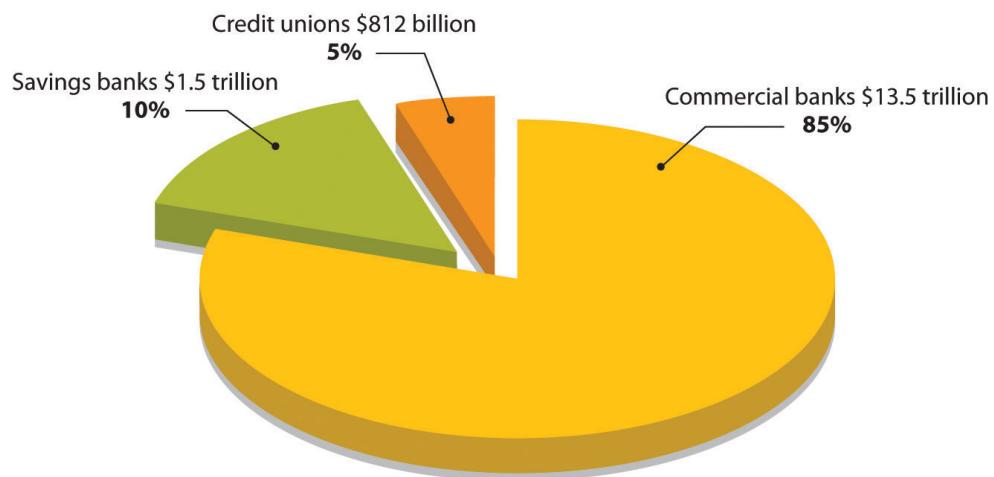


Figure 13.3 Where Our Money Is Deposited

Finance Companies

Finance companies are nondeposit institutions because they don't accept deposits from individuals or provide traditional banking services, such as checking accounts. They do, however, make loans to individuals and businesses, using funds acquired by selling securities or borrowed from commercial banks. They hold about \$1.9 trillion in assets (Insurance Information Institute, 2010). Those that lend money to businesses, such as General Electric Capital Corporation, are *commercial finance companies*, and those that make loans to individuals or issue credit cards, such as Citigroup, are *consumer finance companies*. Some, such as General Motors Acceptance Corporation, provide loans to both consumers (car buyers) and businesses (GM dealers).

Insurance Companies

Insurance companies sell protection against losses incurred by illness, disability, death, and property damage. To finance claims payments, they collect premiums from policyholders, which they invest in stocks, bonds, and other assets. They also use a portion of their funds to make loans to individuals, businesses, and government agencies.

Brokerage Firms

Companies like A.G. Edwards & Sons and T. Rowe Price, which buy and sell stocks, bonds, and other investments for clients, are **brokerage firms** (also called *securities investment dealers*). A **mutual fund** invests money from a pool of investors in stocks, bonds, and other securities. Investors become part owners of the fund. Mutual funds reduce risk by diversifying investment: because assets are invested in dozens of companies in a variety of industries, poor performance by some firms is usually offset by good performance by others. Mutual funds may be stock funds, bond funds, and **money market funds**, which invest in safe, highly liquid securities. (Recall our definition of *liquidity* in [Chapter 12 “The Role of Accounting in Business”](#) as the speed with which an asset can be converted into cash.)

Finally, **pension funds**, which manage contributions made by participating employees and employers and provide members with retirement income, are also nondeposit institutions.

Financial Services

You can appreciate the diversity of the services offered by commercial banks, savings banks, and credit unions by visiting their Web sites. For example, Wells Fargo promotes services to four categories of customers: individuals, small businesses, corporate and institutional clients, and affluent clients seeking “wealth management.” In addition to traditional checking and savings accounts, the bank offers automated teller machine (ATM) services, credit cards, and debit cards. It lends money for homes, cars, college, and other personal and business needs. It provides financial advice and sells securities and other financial products, including **individual retirement account (IRA)**, by which investors can save money that's tax free until they retire. Wells Fargo even offers life, auto, disability, and homeowners insurance. It also provides electronic banking for customers who want to check balances, transfer funds, and pay bills online (Wells Fargo, 2011).

Bank Regulation

How would you react if you put your life savings in a bank and then, when you went to withdraw it, learned that the bank had failed—that your money no longer existed? This is exactly what happened to many people during the Great Depression. In response to the crisis, the federal government established the **Federal Depository Insurance Corporation (FDIC)** in 1933 to restore confidence in the banking system. The FDIC insures deposits in commercial banks and savings banks up to \$250,000. So today if your bank failed, the government would give you back your money (up to \$250,000). The money comes from fees charged member banks.

To decrease the likelihood of failure, various government agencies conduct periodic examinations to ensure that institutions are in compliance with regulations. Commercial banks are regulated by the FDIC, savings banks by the Office of Thrift Supervision, and credit unions by the National Credit Union Administration. As we'll see later in the chapter, the Federal Reserve System also has a strong influence on the banking industry.

Crisis in the Financial Industry (and the Economy)

What follows is an interesting, but scary, story about the current financial crisis in the banking industry and its effect on the economy. In the years between 2001 and 2005, lenders made billions of dollars in subprime adjustable-rate mortgages (ARMs) to American home buyers. Subprime loans are made to home buyers who don't qualify for market-set interest rates because of one or more risk factors—income level, employment status, credit history, ability to make only a very low down payment. In 2006 and 2007, however, housing prices started to go down. Many homeowners with subprime loans, including those with ARMs whose rates had gone up, were able neither to refinance (to lower their interest rates) nor to borrow against their homes. Many of these homeowners got behind in mortgage payments, and foreclosures became commonplace—1.3 million in 2007 alone (Lahart, 2011). By April 2008, 1 in every 519 American households had received a foreclosure notice (RealtyTrac Inc., 2011). By August, 9.2 percent of the \$12 trillion in U.S. mortgage loans was delinquent or in foreclosure (Mortgage Bankers Association, 2008; Duhigg, 2011).

The repercussions? Banks and other institutions that made mortgage loans were the first sector of the financial industry to be hit. Largely because of mortgage-loan defaults, profits at more than 8,500 U.S. banks dropped from \$35 billion in the fourth quarter of 2006 to \$650 million in the corresponding quarter of 2007 (a decrease of 89 percent). Bank earnings for the year 2007 declined 31 percent and dropped another 46 percent in the first quarter of 2008 (Federal Deposit Insurance Corporation, 2008; FDIC, 2008).

Losses in this sector were soon felt by two publicly traded government-sponsored organizations, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Both of these institutions are authorized to make loans and provide loan guarantees to banks, mortgage companies, and other mortgage lenders; their function is to make sure that these lenders have enough money to lend to prospective home buyers. Between them, Fannie Mae and Freddie Mac backed approximately half of that \$12 trillion in outstanding mortgage loans, and when the mortgage crisis hit, the stock prices of the two corporations began to drop steadily. In September 2008, amid fears that both organizations would run out of capital, the U.S. government took over their management.

Freddie Mac also had another function: to increase the supply of money available in the country for mortgage loans and new home purchases, Freddie Mac bought mortgages from banks, bundled these mortgages, and sold the bundles to investors (as mortgage-backed securities). The investors earned a return because they received cash from the monthly mortgage payments. The banks that originally sold the mortgages to Freddie Mac used the cash they got from the sale to make other loans. So investors earned a return, banks got a new influx of cash to make more loans, and individuals were able to get mortgages to buy the homes they wanted. This seemed like a good deal for everyone, so many major investment firms started doing the same thing: they bought individual subprime mortgages from original lenders (such as small banks), then pooled the mortgages and sold them to investors.

But then the bubble burst. When many home buyers couldn't make their mortgage payments (and investors began to get less money and consequently their return on their investment went down), these mortgage-backed securities plummeted in value. Institutions that had invested in them—including investment banks—suffered significant losses (Tully, 2007). In September 2008, one of these investment banks, Lehman Brothers, filed for bankruptcy protection; another, Merrill Lynch, agreed to sell itself for \$50 billion. Next came American International Group (AIG), a giant insurance company that insured financial institutions against the risks they took in lending and investing money. As its policyholders buckled under the weight of defaulted loans and failed investments, AIG, too, was on the brink of bankruptcy, and when private efforts to bail it out failed, the U.S. government stepped in with a loan of \$85 billion (Robb, et. al., 2008). The U.S. government also agreed to buy up risky mortgage-backed securities from teetering financial institutions at an estimated cost of “hundreds of billions” (Mortgage Bankers Association, 2008). And the banks

started to fail—beginning with the country’s largest savings and loan, Washington Mutual, which had 2,600 locations throughout the country. The list of failed banks kept getting longer: by November of 2008, it had grown to nineteen.

The economic troubles that began in the banking industry as a result of the subprime crisis spread to the rest of the economy. Credit markets froze up and it became difficult for individuals and businesses to borrow money. Consumer confidence dropped, people stopped spending, businesses cut production, sales dropped, company profits fell, and many lost their jobs. It would be nice if this story had an ending (and even nicer if it was positive), but it might take us years before we know the ending. At this point in time, all we do know is that the economy is going through some very difficult times and no one is certain about the outcome. As we head into 2012, one in three Americans believe the United States is headed in the wrong direction. Our debt has been downgraded by Moody’s, a major credit rating agency. Unemployment seems stuck at around 9 percent, with the long-term unemployed making up the biggest portion of the jobless since records began in 1948. “As the superpower’s clout seems to ebb towards Asia, the world’s most consistently inventive and optimistic country has lost its mojo” (The Economist, 2011).

How Banks Expand the Money Supply

When you deposit money, your bank doesn’t set aside a special pile of cash with your name on it. It merely records the fact that you made a deposit and increases the balance in your account. Depending on the type of account, you can withdraw your share whenever you want, but until then, it’s added to all the other money held by the bank. Because the bank can be pretty sure that all its depositors won’t withdraw their money at the same time, it holds on to only a fraction of the money that it takes in—its *reserves*. It lends out the rest to individuals, businesses, and the government, earning interest income and expanding the money supply.

The Money Multiplier

Precisely how do banks expand the money supply? To find out, let’s pretend you win \$10,000 at the blackjack tables of your local casino. You put your winnings into your savings account immediately. The bank will keep a fraction of your \$10,000 in reserve; to keep matters simple, we’ll use 10 percent. The bank’s reserves, therefore, will increase by \$1,000 ($\$10,000 \times 0.10$). It will then lend out the remaining \$9,000. The borrowers (or the parties to whom they pay it out) will then deposit the \$9,000 in their own banks. Like your bank, these banks will hold onto 10 percent of the money (\$900) and lend out the remainder (\$8,100). Now let’s go through the process one more time. The borrowers of the \$8,100 (or, again, the parties to whom they pay it out) will put this amount into their banks, which will hold onto \$810 and lend the remaining \$7,290. As you can see in [Figure 13.4 “The Effect of the Money Multiplier”](#), total bank deposits would now be \$27,100. Eventually, bank deposits would increase to \$100,000, bank reserves to \$10,000, and loans to \$90,000. A shortcut for arriving at these numbers depends on the concept of the **money multiplier**, which is determined using the following formula:

Money multiplier = 1/Reserve requirement

In our example, the money multiplier is $1/0.10 = 10$. So your initial deposit of \$10,000 expands into total deposits of \$100,000 ($\$10,000 \times 10$), additional loans of \$90,000 ($\$9,000 \times 10$), and increased bank reserves of \$10,000 ($\$1,000 \times 10$). In reality, the multiplier will actually be less than 10. Why? Because some of the money loaned out will be held as currency and won’t make it back into the banks.

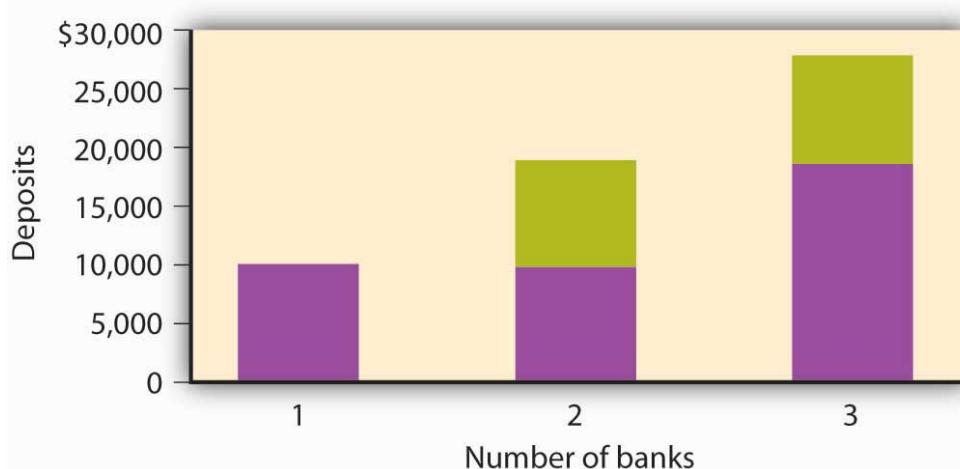


Figure 13.4 The Effect of the Money Multiplier

Key Takeaways

- Financial institutions serve as financial intermediaries between savers and borrowers and direct the flow of funds between the two groups.
- Those that accept deposits from customers—depository institutions—include **commercial banks**, **savings banks**, and **credit unions**; those that don’t—nondepository institutions—include **finance companies**, **insurance companies**, and **brokerage firms**.
- Financial institutions offer a wide range of services, including checking and savings accounts, ATM services, and credit and debit cards. They also sell securities and provide financial advice.
- A bank holds onto only a fraction of the money that it takes in—an amount called its **reserves**—and lends the rest out to individuals, businesses, and governments. In turn, borrowers put some of these funds back into the banking system, where they become available to other borrowers. The **money multiplier** effect ensures that the cycle expands the money supply.

Exercises

1. (AACSB) Analysis

Does the phrase “The First National Bank of Wal-Mart” strike a positive or negative chord? Wal-Mart isn’t a bank, but it does provide some financial services: it offers a no-fee Wal-Mart Discovery credit card with a 1 percent cash-back feature, cashes checks and sells money orders through an alliance with MoneyGram International, and houses bank branches in more than a thousand of its superstores. Through a partnering arrangement with SunTrust Banks, the retailer has also set up in-store bank operations at a number of outlets under the cobranded name of “Wal-Mart Money Center by SunTrust.” A few years ago, Wal-Mart made a bold attempt to buy several banks but dropped the idea when it encountered stiff opposition. Even so, some experts say that it’s not a matter of *whether* Wal-Mart will become a bank, but a matter of *when*. What’s your opinion? Should Wal-Mart be allowed to enter the financial-services industry and offer checking and savings accounts, mortgages, and personal and business loans? Who would benefit if Wal-Mart became a key player in the financial-services arena? Who would be harmed?

2. (AACSB) Analysis

Congratulations! You just won \$10 million in the lottery. But instead of squandering your newfound wealth on luxury goods and a life of ease, you’ve decided to stay in town and be a financial friend to your neighbors, who are hardworking but never seem to have enough money to fix up their homes or buy decent cars. The best way, you decide, is to start a bank that will make home and car loans at attractive rates. On the day that you open your doors, the reserve requirement set by the Federal Reserve System is 10 percent. What’s the maximum amount of money you can lend to residents of the town? What if the Fed raises the reserve requirement to 12 percent? Then how much could you lend? In changing the reserve requirement from 10 percent to 12 percent, what’s the Fed trying to do—curb inflation or lessen the likelihood of a recession? Explain how the Fed’s action will contribute to this goal.

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13.3: The Federal Reserve System

Learning Objective

1. Identify the goals of the Federal Reserve System and explain how it uses monetary policy to control the money supply and influence interest rates.



Figure 13.5. The Federal Reserve Building in Washington, DC. Tim Evanson – [Federal Reserve Building – eagle](#) – CC BY-SA 2.0.

Who decides how much banks should keep in reserve? The decision is made by the Federal Reserve System (popularly known as “the Fed”), a central banking system established in 1913. Most large banks belong to the Federal Reserve System, which divides the country into twelve districts, each with a member-owned Federal Reserve Bank. The twelve banks are coordinated by a board of governors.

The Tools of the Fed

The Fed has three major goals:

1. Price stability
2. Sustainable economic growth
3. Full employment (Federal Reserve System, 2011)

Recall our definition of *monetary policy* in [Chapter 1 “The Foundations of Business”](#) as the efforts of the Federal Reserve System to regulate the nation’s money supply. We also defined *price stability* as conditions under which the prices for products remain fairly constant. Now, we can put the two concepts together: the Fed seeks to stabilize prices by regulating the money supply and interest rates. In turn, stable prices promote economic growth and full employment—at least in theory. To conduct monetary policy, the Fed relies on three tools: *reserve requirements*, the *discount rate*, and *open market operations*.

Reserve Requirements

Under what circumstances would the Fed want to change the reserve requirement for banks? The purpose of controlling the money supply is primarily to lessen the threat of *inflation* (a rise in the overall price level) or *recession* (an economic slowdown gauged by a decline in gross domestic product). Here’s how it works (again, in theory). If the Fed *raises* the reserve requirement (for example, from 10 percent to 11 percent), banks must set aside more money. Consequently, they have *less to lend* and so raise their interest

rates. Under these conditions, it's harder and more expensive for people to borrow money, and if they can't borrow as much, they can't spend as much, and if people don't spend as much, prices don't go up. Thus, the Fed has lessened the likelihood of inflation.

Conversely, when the Fed *lowers* the reserve requirement (for example, from 10 percent to 9 percent), banks need to set aside less money. Because they have *more money to lend*, they keep interest rates down. Borrowers find it easier and cheaper to get money for buying things, and the more consumers buy, the higher prices go. In this case, the Fed has reduced the likelihood of a recession.

A 1 percent change in the reserve requirement, whether up to 11 percent or down to 9 percent, may not seem like much, but remember our earlier discussion of the *money multiplier*: because of the money-multiplier effect, a small change in the reserve requirement has a dramatic effect on the money supply. (For the same reason, the Fed changes reserve requirements only rarely.)

The Discount Rate

To understand how the Fed uses the discount rate to control the money supply, let's return to our earlier discussion of reserves. Recall that banks must keep a certain fraction of their deposits as reserves. The bank can hold these reserve funds or deposit them into a Federal Reserve Bank account. Recall, too, that the bank can lend out any funds that it doesn't have to put on reserve. What happens if a bank's reserves fall below the required level? The Fed steps in, permitting the bank to "borrow" reserve funds from the Federal Reserve Bank and add them to its reserve account at the Bank. There's a catch: the bank must pay interest on the borrowed money. The rate of interest that the Fed charges member banks is called the **discount rate**. By manipulating this rate, the Fed can make it appealing or unappealing to borrow funds. If the rate is high enough, banks will be reluctant to borrow. Because they don't want to drain their reserves, they cut back on lending. The money supply, therefore, decreases. By contrast, when the discount rate is low, banks are more willing to borrow because they're less concerned about draining their reserves. Holding fewer excess reserves, they lend out a higher percentage of their funds, thereby increasing the money supply.

Even more important is the carryover effect of a change in the discount rate to the overall level of interest rates (Heilbroner & Thurow, 1998). When the Fed adjusts the discount rate, it's telling the financial community where it thinks the economy is headed —up or down. Wall Street, for example, generally reacts unfavorably to an increase in the discount rate. Why? Because the increase means that interest rates will probably rise, making future borrowing more expensive.

Open Market Operations

The Fed's main tool for controlling the money supply and influencing interest rates is called **open market operations**: the sale and purchase of U.S. government bonds by the Fed in the open market. To understand how this process works, we first need to know a few facts:

- The Fed's assets include a substantial dollar amount of government bonds.
- The Fed can buy or sell these bonds on the open market (consisting primarily of commercial banks).
- Because member banks use cash to buy these bonds, they decrease their reserve balances when they buy them.
- Because member banks receive cash from the sale of the bonds, they increase their reserve balances when they sell them.
- Banks must maintain a specified balance in reserves; if they dip below this balance, they have to make up the difference by borrowing money.

If the Fed wants to decrease the money supply, it can *sell* bonds, thereby reducing the reserves of the member banks that buy them. Because these banks would then have less money to lend, the money supply would decrease. If the Fed wants to increase the money supply, it will *buy* bonds, increasing the reserves of the banks that sell them. The money supply would increase because these banks would then have more money to lend.

The Federal Funds Rate

In conducting open market operations, the Fed is trying to do the same thing that it does in using its other tools—namely, to influence the money supply and, thereby, interest rates. But it also has something else in mind. To understand what that is, you need to know a few more things about banking. When a bank's reserve falls below its required level, it may, as we've seen, borrow from the Fed (at the discount rate). But it can also borrow from other member banks that have excess reserves. The rate that banks pay when they borrow through this channel is called the **federal funds rate** (Federal Reserve System, 2011).

How does the federal funds rate affect the money supply? As we've seen, when the Fed sells bonds in the open market, the reserve balances of many member banks go down. To get their reserves back to the required level, they must borrow, whether from the Fed or from other member banks. When Bank 1 borrows from Bank 2, Bank 2's supply of funds goes down; thus, it increases the interest rate that it charges. In short, the increased demand for funds drives up the federal funds rate.

All this interbank borrowing affects you, the average citizen and consumer. When the federal funds rate goes up, banks must pay more for their money, and they'll pass the cost along to their customers: banks all over the country will raise the interest rates charged on mortgages, car loans, and personal loans. [Figure 13.6 “Key Interest Rates, 2002–2011”](#) charts ten-year fluctuations in the discount rate, federal funds rate, and **prime rate**—the rate that banks charge their best customers. Because all three rates tend to move in the same direction, borrowers—individuals, as well as organizations—generally pay more to borrow money when banks have to pay more and less when banks have to pay less. Notice that the prime rate (which banks charge their customers) is higher than both the federal funds and discount rates (which banks must pay when they need to borrow). That's why banks make profits when they make loans. Note, too, that the Fed lowered the discount rate and federal funds rate drastically in 2008 in an attempt to stimulate a weakening economy. Despite continued low rates through 2011, the economy is still very weak.

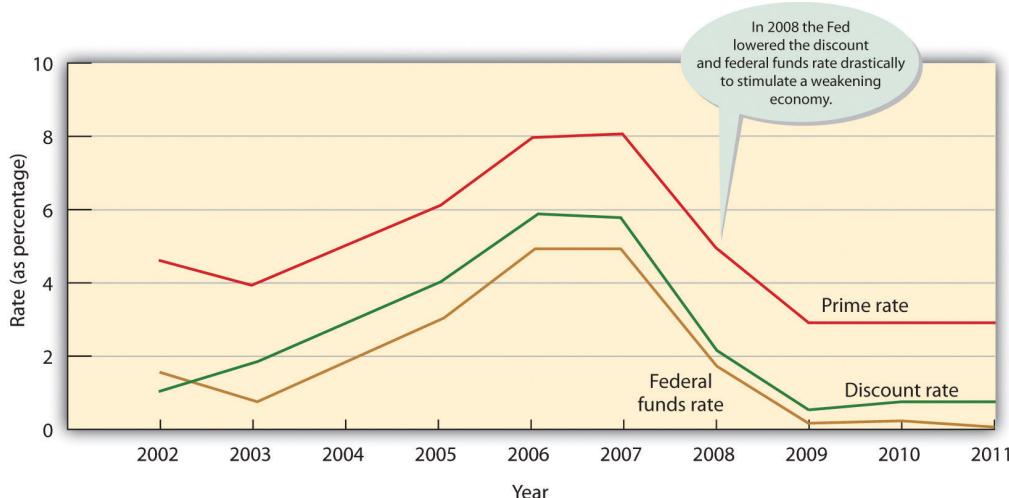


Figure 13.6 Key Interest Rates, 2002–2011

The Banker's Bank and the Government's Banker

The Fed performs another important function: it serves its member banks in much the same way as your bank serves you. When you get a check, you deposit it in your checking account, thereby increasing your balance. When you pay someone by check, the dollar amount of the check is charged to your account, and your balance goes down. The Fed works in much the same way, except that its customers are member banks. Just as your bank clears your check, the Fed clears the checks that pass through its member banks. The monumental task of clearing more than fifteen billion checks a year is complicated by the fact that there are twelve district banks. If someone in one district (for example, Boston) writes a check to a payee in another district (say, San Francisco), the check must be processed through both districts (Federal Reserve System, 2011).

Prior to 2004, clearing checks took days because the checks themselves needed to be physically moved through the system. But thanks to the passage of Check 21 (a U.S. federal law), things now move much more quickly. Instead of physically transporting checks, banks are allowed to make an image of the front and back of a check and send the digital version of the original check, called a “substitute” check, through the system electronically (Privacy Rights Clearinghouse, 2011). The good news is that Check 21 shortened the time it takes to clear a check, often down to one day. The bad news is that Check 21 shortened the time it takes to clear a check, which increases the risk that a check you write will bounce. So be careful: don't write a check unless you have money in the bank to cover it.

In performing the following functions, the Fed is also the U.S. government's banker:

- Holding the U.S. Treasury's checking account
- Processing the paperwork involved in buying and selling government securities
- Collecting federal tax payments
- Lending money to the government by purchasing government bonds from the Treasury

The Fed also prints, stores, and distributes currency and destroys it when it's damaged or worn out. Finally, the Fed, in conjunction with other governmental agencies, supervises and regulates financial institutions to ensure that they operate soundly and treat customers fairly and equitably (Federal Reserve System, 2011).

Key Takeaways

- Most large banks are members of the central banking system called the **Federal Reserve System** (commonly known as “the Fed”).
- The Fed’s goals include price stability, sustainable economic growth, and full employment. It uses *monetary policy* to regulate the money supply and the level of interest rates.
- To achieve these goals, the Fed has three tools:
 1. it can raise or lower reserve requirements—the percentage of its funds that banks must set aside and can’t lend out;
 2. it can raise or lower the **discount rate**—the rate of interest that the Fed charges member banks to borrow “reserve” funds;
 3. it can conduct **open market operations**—buying or selling government securities on the open market.

Exercise

(AACSB) Analysis

Answer this three-part question on the Federal Reserve:

1. What is the Federal Reserve?
2. What is the purpose of the Federal Reserve? What are its goals?
3. How does the Federal Reserve affect the U.S. economy?

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13.4: The Role of the Financial Manager

Learning Objectives

1. Explain the ways in which a new business gets start-up cash.
2. Identify approaches used by existing companies to finance operations and growth.

So far, we've focused our attention on the financial environment in which U.S. businesses operate. Now let's focus on the role that finance plays within an organization. In Chapter 1 "The Foundations of Business", we defined *finance* as all the activities involved in planning for, obtaining, and managing a company's funds. We also explained that a *financial manager* determines how much money the company needs, how and where it will get the necessary funds, and how and when it will repay the money that it has borrowed. The financial manager also decides what the company should do with its funds—what investments should be made in plant and equipment, how much should be spent on research and development, and how excess funds should be invested.

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13.5: Understanding Securities Markets

Learning Objectives

1. Show how the securities market operates and how it's regulated.
2. Understand how market performance is measured.

So, before long, you're a publicly traded company. Fortunately, because your degree in finance comes with a better-than-average knowledge of financial markets, you're familiar with the ways in which investors will evaluate your company. Investors will look at the overall quality of the company and ask some basic questions:

- How well is it managed?
- Is it in a growing industry? Is its market share increasing or decreasing?
- Does it have a good line of products? Is it coming out with innovative products?
- How is the company doing relative to its competitors?
- What is its future? What is the future of its industry?

Investors also analyze the company's performance over time and ask more-specific questions:

- Are its sales growing?
- Is its income going up?
- Is its stock price rising or falling?
- Are earnings per share rising?

They'll assess the company's financial strength, asking another series of specific questions:

- Can it pay its bills on time?
- Does it have too much debt?
- Is it managing its productive assets (such as inventory) efficiently?

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13.6: Financing the Going Concern

Learning Objective

1. Define equity and debt financing, and discuss the advantages and disadvantages of each financing approach.

Let's assume that taking your company public was a smart move: in posing questions like those that we've just listed, investors have decided that your business is a good buy. With the influx of investment capital, the little laundry business that you started in your dorm ten years ago has grown into a very large operation with laundries at more than seven hundred colleges all across the country, and you're opening two or three laundries a week. But there's still a huge untapped market out there, and you've just left a meeting with your board of directors at which it was decided that you'll seek additional funding for further growth. Everyone agrees that you need about \$8 million for the proposed expansion, yet there's a difference of opinion among your board members on how to go about getting it. You have two options:

1. Equity financing: raising the needed capital through the sale of stock
2. Debt financing: raising the needed capital by selling bonds

Let's review some of the basics underlying your options.

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13.7: Careers in Finance

Learning Objective

1. Discuss career opportunities in finance.

A financial career path offers a number of interesting, entry-level jobs that can develop into significant senior-level positions. In addition to a strong finance education, you'll need to be familiar with both accounting and economics. Along with possessing strong analytical skills and the ability to assess financial data, you'll need to work effectively with colleagues throughout an organization. So you'll need good interpersonal and communication skills: you'll have to write and speak clearly and, in particular, you'll have to be able to present complex financial data in terms that everyone can understand.

Generally, most positions in finance fall into one of three broad areas: *commercial banking*, *corporate finance*, and the *investment industry*.

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13.8: Cases and Problems

Learning on the Web (AACSB)

How Much Should You Reveal in *Playboy*?

What can you do if you're sitting around your dorm room with nothing else to do (or at least nothing else you want to do)? How about starting a business? It worked for Michael Dell, who found assembling and selling computers more rewarding than attending classes at the University of Texas. It also worked for two Stanford graduate students, Sergey Brin and Larry Page. They came up with a novel (though fairly simple) idea for a search engine that ranked Web sites according to number of hits and online linkages. Because their goal was to organize massive amounts of electronic data, they wanted a name that connoted seemingly infinite volumes of information. They liked the word "googol" (a child's coinage for a very big number—1 followed by a hundred zeros), but, unfortunately, someone already owned the domain name "Googol." So Brin and Page did a little letter juggling and settled (as we all know by now) for "Google."

By 2004, the company that they'd started in 1998 was the number-one search engine in the world. Their next step, like that of so many successful entrepreneurs before them, was to go public, and that's where our exercise starts. To learn more about this episode in the epic story of Google—and to find out what role *Playboy* magazine plays in it—read the article, "Google Sets \$2.7 Billion IPO" (<http://money.cnn.com/2004/04/29/technology/google>), read Google's *Playboy* interview (<http://www.google-watch.org/playboy.html>), and read the *BusinessWeek* article, "Google Dodges a Bullet" (http://www.businessweek.com/technolo...0781_tc119.htm).

When you've finished reading the articles, answer the following questions:

1. What's an IPO? Why did Brin and Page take their company public? What disadvantages did they incur by going public? Are they likely to lose control of their company?
2. How does a *Playboy* interview enter into the Google story? What did Brin and Page do wrong? (By the way, the interview appeared in the August 2004 issue of *Playboy*; because Google incorporated the text into its revised IPO filing, it's now in the public domain and available online.)
3. Did the Google founders get off the hook? Was the punishment (or lack of it) appropriate? Quitting school to run Google paid off big for Brin and Page. Their combined net worth as a result of the IPO suddenly skyrocketed to \$8 billion. But how about you? Could you have gotten rich if you'd jumped on the Google bandwagon just as it started to roll? Could you at least have earned enough to pay another year's tuition? To respond to these questions, you need to know two things: (1) the IPO price of Google stock—\$85—and (2) Google's current stock price. To find the current price, go to finance.yahoo.com to link to the finance section of the [Yahoo.com](http://www.Yahoo.com) Web site. Enter Google's stock symbol—GOOG—and click "Go." When you find the current stock price, answer the following questions:
 - a. If you'd bought Google stock on the IPO date and sold it today, how many shares of Google would you have had to buy in order to make enough to cover this year's tuition?
 - b. If you owned Google stock today, would you sell it or hold it? Explain your answer.

Career Opportunities

Financial Futures

One advantage of a finance major is that it prepares you for a wide range of careers. Some graduates head for Wall Street to make big bucks in investment banking. Others prefer the security of working in the corporate finance department of a large firm, while still others combine finance and selling in fields such as insurance or real estate. If you like working with other people's finances, you might end up in commercial banking or financial planning. To better acquaint yourself with the range of available finance careers, go to <http://www.careers-in-finance.com/> to link to the Careers in Finance Web site. After reviewing the descriptions of each career option, select two areas that you find particularly interesting and two that you find unattractive. For each of your four selections, answer the following questions:

1. Why do you find a given area interesting (or unattractive)?
2. What experience and expertise are entailed by a career in a given area?

Ethics Angle (AACSB)

The Inside Story

You're the founder and CEO of a publicly traded biotech firm that recently came up with a promising cancer drug. Right now, life on Wall Street is good: investors are high on your company, and your stock price is rising. On top of everything else, your personal wealth is burgeoning because you own a lot of stock in the company. You're simply waiting to hear from the FDA, which is expected to approve the product. But when the call comes, the news is bad: the FDA has decided to delay approval because of insufficient data on the drug's effectiveness. You know that when investors hear the news, the company's stock price will plummet. The family and friends that you encouraged to buy into your company will lose money, and you'll take a major hit.

Quickly, you place an order to sell about \$5 million worth of your own stock. Then you start making phone calls. You tell your daughter to dump her stock, and you advise your friends to do the same thing. When you tell your stockbroker the news, he gets on the phone and gives a heads-up to his other clients. Unfortunately, he can't reach one client (who happens to be a good friend of yours), so he instructs his assistant to contact her and tell her what's happened. As a result, the client places an order to sell four thousand shares of stock at a market value of \$225,000.

Let's pause at this point to answer a few questions:

1. Are you being a nice guy or doing something illegal?
2. Is your stockbroker doing something illegal?
3. Is the assistant doing something illegal or merely following orders?
4. Is the stockbroker's client acting illegally?

Fast-forward a few months. Federal investigators are interested in the sale of your stock and the sale of your daughter's stock. Because all signs point to the truth as being an invitation to trouble, you lie. When they talked with your friend about her sale, say investigators, she explained a standing agreement that instructed her broker to sell the stock when the market price went below a specified level. It sounds like a good explanation, so you go along with it.

Now, answer this question.

5. What have you done wrong? What has your client friend done wrong?

The Reality Version of the Story

At this point, let's stop protecting the not-so-innocent and name some names. The biotech company is ImClone, and its founder and CEO is Dr. Samuel Waksal. The Merrill Lynch broker is named Peter Bacanovic and his assistant Douglas Faneuil. The client friend who dumped her stock is Martha Stewart.

Let's focus on Stewart, who is the founder of Martha Stewart Living Omnimedia, a prosperous lifestyle empire. Her actions and their consequences are detailed in an article titled "Martha's Fall," which you can access by going to www.newsweek.com/id/53363 and linking to the MSNBC Web site. Read the article and then answer the following questions:

6. Do you believe Stewart's story that she sold the stock because of a preexisting sell order and not because she learned that the cancer drug wouldn't be approved? What did she do that was illegal? What was she actually *convicted* of doing?
7. Waksal got seven years in prison for insider trading (and a few other illegal schemes). Bacanovic (Stewart's broker) got five months in jail and five months of home confinement for lying and obstructing the investigation into the sale of ImClone stock. In return for helping the prosecutors convict Stewart, Faneuil (the broker's assistant) got a federal "get-out-of-jail" card but was fined \$2,000 for accepting a payoff (namely, an extra week of vacation and a bump in his commission) to stonewall investigators. Stewart went to prison for five months and spent another five under house arrest. Was her punishment too lenient? Too harsh? If you'd been the judge, what sentence would you have given her?
8. How could Stewart have avoided prison? Did her celebrity status or reputation help or hurt her? Did she, as some people claim, become a poster CEO for corporate wrongdoing?
9. Why are government agencies, such as the SEC, concerned about insider trading? Who's hurt by it? Who's helped by government enforcement of insider-trading laws?

Team-Building Skills (AACSB)

Looking for a High-Flying Stock

Congratulations! Your team has just been awarded \$100,000 in hypothetical capital. There is, however, a catch: you have to spend the money on airline stocks. Rather than fly by the seat of your pants, you'll want to research a number of stocks. To familiarize yourself with the airline industry, go to www.airlines.org/Economics/Re...yEconomic.aspx to link to and read the article: "2010 Airline Industry Economic Perspective."

Each team member is responsible for researching and writing a brief report on a different company. Don't duplicate your research. Be sure to include low-cost airlines as well as larger carriers. To cover the industry, pick airlines from the following list. The URLs bring you to each airline's information page on Yahoo! Finance. If any of the links listed below do not work, you can get to that airline's page by doing the following: Go to beta.finance.yahoo.com/; under "Investing" on the top bar, select "Industries" from the drop-down list. Then click on "Complete Industry List" on left sidebar. Under "Services" click on "Major Airlines" and then "Company Index" to find the first four airlines listed below (AMR/American, Delta, U.S. Airways, and Spirit); click on "Regional Airlines" to find the remaining two airlines (Jet Blue and Southwest).

- AMR Corporation (American Airlines) (biz.yahoo.com/ic/10/10021.html)
- Delta Air Lines (biz.yahoo.com/ic/10/10448.html)
- U.S. Airways (biz.yahoo.com/ic/11/11527.html)
- Spirit Airlines (biz.yahoo.com/ic/11/11527.html)
- Jet Blue Airways (biz.yahoo.com/ic/99/99674.html)
- Southwest Airlines (biz.yahoo.com/ic/11/11377.html)

Each member should prepare a report detailing the following information about his or her chosen company:

- A description of the airline
- The percentage change in revenue over the last fiscal year
- The percentage change in net income over the last fiscal year
- A chart comparing the movement in the company's stock price over the past year with the movement of the DJIA
- Current earnings per share (EPS): net income divided by number of common shareholders
- Current PE ratio
- Current stock price

Here are some hints for finding this information on the Yahoo! page devoted to a given company:

- The company will be described in a "Company Profile" appearing toward the top of the page.
- You can get the remaining information by going to the bottom of the page and clicking on the following:
 - "Financials" for changes in revenues and net income
 - "Chart" for trends in stock prices
 - "Quote" for EPS, PE ratio, and current stock price
- When reviewing financial statements to calculate percentage changes in revenues and net income, be sure you click on "Annual Data" to get information for the entire year rather than for just the quarter.

Team Report

Once each member has researched one airline, the team should get together and decide how to invest its \$100,000. Announce your decision in a final report that includes the following items:

1. An overall description and assessment of the airline industry, including a report on opportunities, threats, and future outlook
2. A decision on how you'll invest your \$100,000, including the names of the stock or stocks that you plan to purchase, current market prices, and numbers of shares
3. An explanation of the team's investment decision
4. Individual member reports on each researched company

Follow-Up

A few weeks later, you might want to check on the stock prices of your picks to see how you'd have done if you'd actually invested \$100,000.

The Global View (AACSB)

Where's the Energy in the Chinese Stock Market?

Warren Buffett is the third-richest man in the world (behind Bill Gates). As CEO of Berkshire Hathaway, a holding company with large stakes in a broad portfolio of investments, Buffett spends a lot of his time looking for companies with promising futures. His time has been quite well spent: the market price of a share in Berkshire Hathaway now tops \$115,000—up from \$16 a share in 1964.

In 2002 and 2003, Berkshire Hathaway paid \$488 million for two million shares in PetroChina, an energy firm 90 percent owned by the Chinese government. In 2007, he sold the stock for \$4 billion, realizing an incredible more than 700 percent gain. To evaluate Buffett's thinking in buying and then selling stock in PetroChina, you'll need to do some research.

First, find out something about the company by going to www.petrochina.com.cn/ptr and linking to the English version of the PetroChina Web site. Explore the sections "About PetroChina" and "Investor Relations." Look for answers to the following questions:

1. What does the company do? What products and services does it provide? How does it distribute its products?
2. On which stock exchanges are its shares sold?

Next, to learn about the company's financial performance, go to finance.yahoo.com to link to the Finance section of the Yahoo.com Web site. Enter the company's stock symbol—PTR—and review the information provided on the site. To see what analysts think of the stock, for example, click on "Analyst Opinion." To gain insight into why Buffett sold his stock and whether it was a good or a bad move, read these articles: "Should We Buy the PetroChina Stock Warren Buffett Sold?" (www.peridotcapitalist.com/200...ck-warren.html) and "Buffett's PetroChina Sale: Fiscal or Social Move," (investorsagainstgenocide.net/page1001126)

Now, answer the following questions:

1. What do analysts think of the stock?
2. Should Buffett have bought the stock in PetroChina? Was it a good decision at the time? Why or why not?
3. Should Buffett have sold his stock in the company? Why do you think he sold the stock? Was it a good decision at the time? Why or why not?
4. If you personally had \$50,000 to invest, how likely is it that you'd buy stock in PetroChina? What factors would you consider in making your decision?

To learn more about the pros and cons of buying stock in Chinese companies, go to www.newsweek.com/id/54174 to link to the MSNBC Web site and read the article "Nice Place to Visit." Then answer these final questions:

1. What are the advantages of investing in the stock of Chinese companies? What are the disadvantages?
2. In your opinion, should the average investor put money in Chinese stock? Why, or why not?

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CHAPTER OVERVIEW

14: Personal Finances

- 14.1: Financial Planning
- 14.2: Time Is Money
- 14.3: The Financial Planning Process
- 14.4: A House Is Not a Piggy Bank- A Few Lessons from the Subprime Crisis
- 14.5: Cases and Problems

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14.1: Financial Planning

Learning Objectives

1. Define *personal finances* and *financial planning*.
2. Explain the *financial planning life cycle*.
3. Discuss the advantages of a college education in meeting short- and long-term financial goals.
4. Describe the steps you'd take to get a job offer and evaluate alternative job offers, taking benefits into account.
5. Understand the ways to finance a college education.

Before we go any further, we need to nail down a couple of key concepts. First, just what, exactly, do we mean by personal finances? *Finance* itself concerns the flow of money from one place to another, and your personal finances concern your money and what you plan to do with it as it flows in and out of your possession. Essentially, then, personal finance is the application of financial principles to the monetary decisions that you make either for your individual benefit or for that of your family.

Second, as we suggested in Section 14—and as we'll insist in the rest of it—monetary decisions work out much more beneficially when they're planned rather than improvised. Thus our emphasis on financial planning—the ongoing process of managing your personal finances in order to meet goals that you've set for yourself or your family.

Financial planning requires you to address several questions, some of them relatively simple:

- What's my annual income?
- How much debt do I have, and what are my monthly payments on that debt?

Others will require some investigation and calculation:

- What's the value of my assets?
- How can I best budget my annual income?

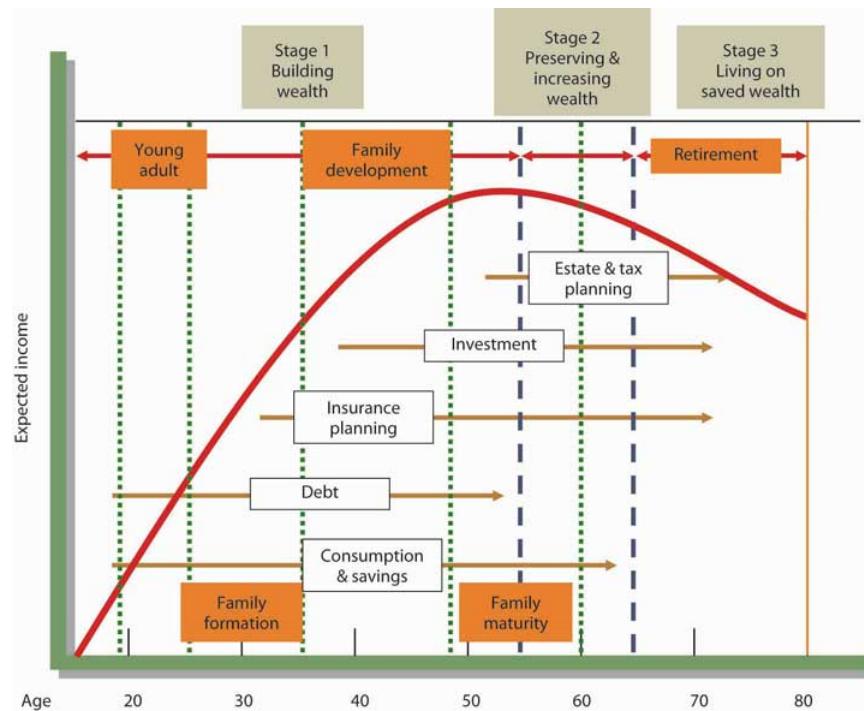
Still others will require some forethought and forecasting:

- How much wealth can I expect to accumulate during my working lifetime?
- How much money will I need when I retire?

The Financial Planning Life Cycle

Another question that you might ask yourself—and certainly would do if you were a professional in financial planning—is something like, “How will my financial plans change over the course of my life?” Figure 14.3 “Financial Life Cycle” illustrates the financial life cycle of a typical individual—one whose financial outlook and likely outcomes are probably a lot like yours (Keown, 2007). As you can see, our diagram divides this individual’s life into three stages, each of which is characterized by different life events (such as beginning a family, buying a home, planning an estate, retiring). At each stage, too, there are recommended changes in the focus of the individual’s financial planning:

Figure 14.3 Financial Life Cycle



At each stage, of course, complications can set in—say, changes in such conditions as marital or employment status or in the overall economic outlook. Finally, as you can also see, your financial needs will probably peak somewhere in stage 2, at approximately age fifty-five, or ten years before typical retirement age.

- In stage 1, the focus is on building wealth.
- In stage 2, the focus shifts to the process of preserving and increasing the wealth that one has accumulated and continues to accumulate.
- In stage 3, the focus turns to the process of living on (and, if possible, continuing to grow) one's saved wealth.

Choosing a Career

Until you're eighteen or so, you probably won't generate much income; for the most part, you'll be living off your parents' wealth. In our hypothetical life cycle, however, financial planning begins in the individual's early twenties. If that seems like rushing things, consider a basic fact of life: this is the age at which you'll be choosing your career—not only the sort of work you want to do during your prime income-generating years, but also the kind of lifestyle you want to live in the process (Keown, 2007).

What about college? Most readers of this book, of course, have decided to go to college. If you haven't yet decided, you need to know that college is an extremely good investment of both money and time.

Table 14.1 “Education and Average Income”, for example, summarizes the findings of a study conducted by the U.S. Census Bureau (U.S. Census Bureau, 2008). A quick review shows that people who graduate from high school can expect to increase their average annual earnings by about 49 percent over those of people who don't, and those who go on to finish college can expect to generate 82 percent more annual income than that. Over the course of the financial life cycle, families headed by those college graduates will earn about \$1.6 million more than families headed by high school graduates who didn't attend college. (With better access to health care—and, studies show, with better dietary and health practices—college graduates will also live longer. And so will their children.) (U.S. Census Bureau, 2008)

Table 14.1 Education and Average Income

Education	Average income	Percentage increase over next-highest level
High school dropout	\$20,873	—
High school diploma	\$31,071	48.9%
College degree	\$56,788	82.8%

Education	Average income	Percentage increase over next-highest level
Advanced higher-education degree	\$82,320	45.0%

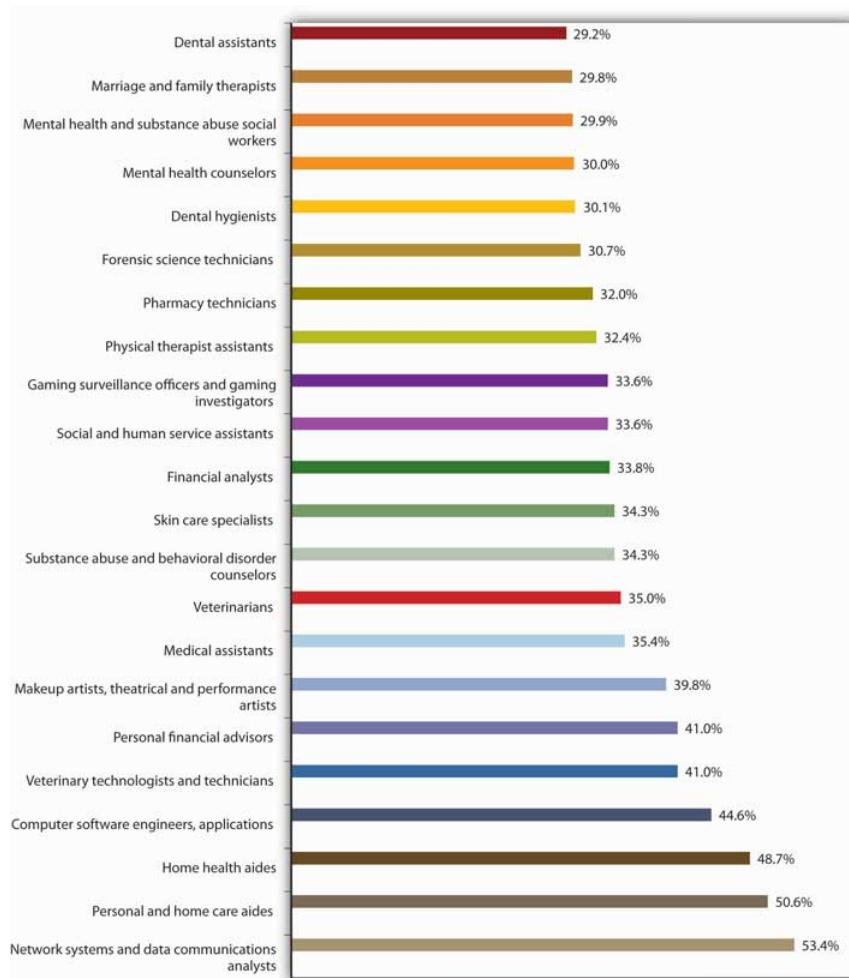
And what about the debt that so many people accumulate to finish college? For every \$1 that you spend on your college education, you can expect to earn about \$35 during the course of your financial life cycle (Hansen, 2008). At that rate of return, you should be able to pay off your student loans (unless, of course, you fail to practice reasonable financial planning).

Naturally, there are exceptions to these average outcomes. You'll find English-lit majors stocking shelves at 7-Eleven, and you'll find college dropouts running multibillion-dollar enterprises. Microsoft cofounder Bill Gates dropped out of college after two years, as did his founding partner, Paul Allen. Current Microsoft CEO Steve Ballmer finished his undergraduate degree but quit his MBA program to join Microsoft (where he apparently fit in among the other dropouts in top management). It's always good to remember, however, that though exceptions to rules (and average outcomes) occasionally modify the rules, they invariably fall far short of disproving them: in entrepreneurship as in most other walks of adult life, the better your education, the more promising your financial future. One expert in the field puts the case for the average person bluntly: educational credentials "are about being employable, becoming a legitimate candidate for a job with a future. They are about climbing out of the dead-end job market" (Ramsay, 2008).

Finally, does it make any difference *what* you study in college? To a perhaps surprising extent, not necessarily. Some career areas, such as engineering, architecture, teaching, and law, require targeted degrees, but the area of study designated on your degree often doesn't matter much when you're applying for a job. If, for instance, a job ad says, "Business, communications, or other degree required," most applicants and hires will have those "other" degrees. When poring over résumés for a lot of jobs, potential employers look for the degree and simply note that a candidate has one; they often don't need to focus on the particulars (Roth, 2008).

This is not to say, however, that all degrees promise equal job prospects. Figure 14.4 "Top 25 Fastest-Growing Jobs, 2006–2016", for example, summarizes a U.S. Bureau of Labor Statistics projection of the thirty fast-growing occupations for the years 2006–2016. Veterinary technicians and makeup artists will be in demand as never before, but as you can see, occupational prospects are fairly diverse¹.

Figure 14.4 Top 25 Fastest-Growing Jobs, 2006–2016



Nor, of course, do all degrees pay off equally. In Table 14.2 “College Majors and Average Annual Earnings”, we’ve extracted the findings of a study conducted by the National Science Foundation on the earnings of individuals with degrees in various undergraduate fields (Penrice, 1999; Harrington & Sum, 2011). Clearly, some degrees—notably in the engineering fields—promise much higher average earnings than others. Chemical engineers, for instance, can earn nearly twice as much as elementary school teachers, but there’s a catch: if you graduate with a degree in chemical engineering, your average annual salary will be about \$67,000 *if you can find a job related to that degree*; if you can’t, you may have to settle for as much as 40 percent less (Penrice, 1999). (Supermodel Cindy Crawford cut short her studies in chemical engineering because there was more money to be made on the runway.)

Table 14.2 College Majors and Average Annual Earnings

Major	Average Earnings with Bachelor's Degree	Major	Average Earnings with Bachelor's Degree
Chemical engineering	\$67,425	History	\$45,926
Aerospace engineering	\$65,649	Biology	\$45,532
Computer engineering	\$62,527	Nursing	\$45,538
Physics	\$62,104	Psychology	\$43,963
Electrical engineering	\$61,534	English	\$43,614
Mechanical engineering	\$61,382	Health technology	\$42,524
Industrial engineering	\$61,030	Criminal justice	\$41,129

Major	Average Earnings with Bachelor's Degree	Major	Average Earnings with Bachelor's Degree
Civil engineering	\$58,993	Physical education	\$40,207
Accounting	\$56,637	Secondary education	\$39,976
Finance	\$55,104	Fine arts	\$38,857
Computer science	\$52,615	Philosophy	\$38,239
Business management	\$52,321	Dramatic arts	\$37,091
Marketing	\$51,107	Music	\$36,811
Journalism	\$46,835	Elementary education	\$34,564
Information systems	\$46,519	Special education	\$34,196

In short, when you're planning what to do with the rest of your life, it's a good idea to check into the fine points and realities, as well as the statistical data. If you talk to career counselors and people in the workforce, you might be surprised by what you learn about the relationship between certain college majors and various occupations. Onetime Hewlett-Packard CEO Carly Fiorina majored in medieval history and philosophy.

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14.2: Time Is Money

Learning Objectives

1. Explain *compound interest* and *the time value of money*.
2. Discuss the value of getting an early start on your plans for saving.

The fact that you have to choose a career at an early stage in your financial life cycle isn't the only reason that you need to start early on your financial planning. Let's assume, for instance, that it's your eighteenth birthday and that on this day you take possession of \$10,000 that your grandparents put in trust for you. You could, of course, spend it; in particular, it would probably cover the cost of flight training for a private pilot's license—something you've always wanted but were convinced that you couldn't afford for another ten or fifteen years. Your grandfather, of course, suggests that you put it into some kind of savings account. If you just wait until you finish college, he says, and if you can find a savings plan that pays 5 percent interest, you'll have the \$10,000 plus another \$2,209 to buy a pretty good used car.

The total amount you'll have—\$12,209—piques your interest. If that \$10,000 could turn itself into \$12,209 after sitting around for four years, what would it be worth if you actually held on to it until you did retire—say, at age sixty-five? A quick trip to the Internet to find a compound-interest calculator informs you that, forty-seven years later, your \$10,000 will have grown to \$104,345 (assuming a 5 percent interest rate). That's not really enough to retire on, but after all, you'd at least have some cash, even if you hadn't saved another dime for nearly half a century. On the other hand, what if that four years in college had paid off the way you planned, so that (once you get a good job) you're able to add, say, another \$10,000 to your retirement savings account every year until age sixty-five? At that rate, you'll have amassed a nice little nest egg of slightly more than \$1.6 million.

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14.3: The Financial Planning Process

Learning Objectives

1. Identify the three stages of the *personal-finances planning process*.
2. Explain how to draw up a personal *net-worth statement*, a personal *cash-flow statement*, and a personal *budget*.

We've divided the financial planning process into three steps:

1. Evaluate your current financial status by creating a net worth statement and a cash flow analysis.
2. Set short-term, intermediate-term, and long-term financial goals.
3. Use a budget to plan your future cash inflows and outflows and to assess your financial performance by comparing budgeted figures with actual amounts.

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14.4: A House Is Not a Piggy Bank- A Few Lessons from the Subprime Crisis

Learning Objectives

1. Discuss the trend in the U.S. savings rate.
2. Define a *subprime loan* and explain the difference between a *fixed-rate mortgage* and an *adjustable-rate mortgage*.
3. Discuss what can go wrong with a subprime loan at an adjustable rate. Discuss what can go wrong with hundreds of thousands of subprime loans at adjustable rates.
4. Define *risk* and explain some of the risks entailed by personal financial transactions.

Joe isn't old enough to qualify, but if his grandfather had deposited \$1,000 in an account paying 7 percent interest in 1945, it would now be worth \$64,000. That's because money invested at 7 percent compounded will double every ten years. Now, \$64,000 may or may not seem like a significant return over fifty years, but after all, the money did all the heavy lifting, and given the miracle of compound interest, it's surprising that Americans don't take greater advantage of the opportunity to multiply their wealth by saving more of it, even in modest, interest-bearing accounts. Ironically, with \$790 billion in credit card debt, it's obvious that a lot of American families are experiencing the effects of compound interest—but in reverse (Frank, 2005).

As a matter of fact, though Joe College appears to be on the right track when it comes to saving, many people aren't. A lot of Americans, it seems, do indeed set savings goals, but in one recent survey, nearly 70 percent of the respondents reported that they fell short of their monthly goals because their money was needed elsewhere. About one-third of Americans say that they're putting away something but not enough, and another third aren't saving anything at all. Almost one-fifth of all Americans have net worth of zero—or less (Taylor, 2007; Frank, 2005).

As we indicated in the opening section of this chapter, this shortage of savings goes hand in hand with a surplus in spending. "My parents," says one otherwise gainfully employed American knowledge worker, "are appalled at the way I justify my spending. I think, 'Why work and make money unless you're going to enjoy it?' That's a fine theory," she adds, "until you're sixty, homeless, and with no money in the bank" (Gardner, 2008). And indeed, if she doesn't intend to alter her personal-finances philosophy, she has good reason to worry about her "older adult" years. Sixty percent of Americans over the age of sixty-five have less than \$100,000 in savings, and only 30 percent of this group have more than \$25,000; 45 percent have less than \$15,000. As for income, 75 percent of people over age sixty-five generate less than \$35,000 annually, and 30 percent are in the "poverty to near-poverty" range of \$10,000 to \$20,000 (as compared to 12 percent of the under-sixty-five population) (Rubin, et. al., 2000).

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14.5: Cases and Problems

Learning on the Web (AACSB)

Go to [https://www.quizze.com\[1\]](https://www.quizze.com[1]) and request a free copy of your credit report. Review the report. If you identify any errors, get them fixed. Write a brief report explaining the value of good credit.

Ethics Angle (AACSB)

Go online and read this article at Forbes.com: "Most Common Resume Lies," by Kate DuBose Tomassi at www.forbes.com/workspecial/2006/05/20/resume-lies-work_cx_kdt_06work_0523lies.html. View the slide show of common résumé lies. Answer these questions: What are the most common lies made in résumés? Why is it a bad idea to lie on such a document? What are the potential consequences of misstating facts on your résumé?

Team-Building Skills (AACSB)

It's becoming more difficult for individuals to buy homes. This has meant that many people who would have bought a home have remained in apartments. In big cities, such as New York, sharing an apartment with roommates is a good way to save money. Yet it has some disadvantages. Get together as a team and identify the pros and cons of sharing housing. Pretend that each member of the group has agreed to share one apartment. Create a document that details each member's rights and responsibilities. Decide as a group whether the lease should be in one person's name or in all your names. Explain the pros and cons of both approaches.

The Global View (AACSB)

You're looking forward to taking a month-long vacation to Australia when you graduate from college in two years. Create a budget for this trip after researching likely costs. Determine how much you'll need for the trip and calculate how much you'd have to save each month to afford the trip.

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CHAPTER OVERVIEW

15: Managing Information and Technology

- 15.1: Data versus Information
- 15.2: Managing Data
- 15.3: Types of Information Systems
- 15.4: Computer Networks and Cloud Computing
- 15.5: Data Communications Networks
- 15.6: Security Issues in Electronic Communication
- 15.7: Careers in Information Management
- 15.8: Cases and Problems

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15.1: Data versus Information

Learning Objectives

1. Distinguish between data and information.
2. Define information system (IS) and identify the tasks of the information systems manager.

By the time the company took the plunge and committed \$100 million to marketing-related information technology (IT), Caesars had been collecting and storing data about customers for almost a decade. “While the company thought it important to collect customer information,” recalls a senior marketing executive, “the problem was we had millions of customers to collect information on, but we had no systematic way of turning it into a marketing decision. We didn’t know what to do with it.” In other words, Caesars was collecting a lot of *data* but not necessarily any *information*. So what’s the difference?

As an example, suppose that you want to know how you’re doing in a particular course. So far, you’ve taken two 20-question multiple-choice tests. On the first, you got questions 8, 11, and 14 wrong; on the second, you did worse, missing items 7, 15, 16, and 19. The items that you got wrong are merely data—unprocessed facts. What’s important is your total score. You scored 85 on the first exam and 80 on the second. These two numbers constitute information—data that have been processed, or turned into some useful form. Knowing the questions that you missed simply supplied you with some data for calculating your scores.

Now let’s fast-forward to the end of the semester. At this point, in addition to taking the two tests, you’ve written two papers and taken a final. You got a 90 and 95 on the papers and a 90 on the final. You now have more processed data, but you still want to organize them into more useful information. What you want to know is your average grade for the semester. To get the information you want, you need yet more data—namely, the weight assigned to each graded item. Fortunately, you’ve known from day one that each test counts 20 percent, each paper 10 percent, and the final exam 40 percent. A little math reveals an average grade of 87.

Though this is the information you’re interested in, it may be mere data to your instructor, who may want different information: an instructor who intends to scale grades, for example, will want to know the average grade for the entire class. You’re hoping that the class average is low enough to push your average of 87 up from a B+ to an A– (or maybe even an A—it doesn’t hurt to hope for the best). The moral of the story is that what constitutes *information* at one stage can easily become *data* at another: or, one person’s information can be another person’s data.

As a rule, you want information; data are good only for generating the information. So, how do you convert data into information that’s useful in helping you make decisions and solve problems? That’s the question we’ll explore in the next section.

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15.2: Managing Data

Learning Objective

1. Explain how IS managers capture, store, and analyze data.

Did you ever think about how much data you yourself generate? Just remember what you went through to start college. First, you had to fill out application forms asking you about test scores, high school grades, extracurricular activities, and finances, plus demographic data about you and your family. Once you'd picked a college, you had to supply data on your housing preferences, the curriculum you wanted to follow, and the party who'd be responsible for paying your tuition. When you registered for classes, you gave more data to the registrar's office. When you arrived on campus, you gave out still more data to have your ID picture taken, to get your computer and phone hooked up, to open a bookstore account, and to buy an on-campus food-charge card. Once you started classes, data generation continued on a daily basis: your food card and bookstore account, for example, tracked your various purchases, and your ID tracked your coming and going all over campus. And you generated grades.

And all these data apply to just one aspect of your life. You also generated data every time you used your credit card and your cell phone. Who uses all these data? How are they collected, stored, analyzed, and distributed in organizations that have various reasons for keeping track of you?

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15.3: Types of Information Systems

Learning Objective

1. Discuss ways in which an IS can be designed to meet the needs of individuals at various organizational levels.

As we saw earlier, different managers, operational units, and functional areas have different information needs. That's why organizations often tailor information systems to meet particular needs. Caesars's IT group, for example, developed the Player Contact System (Dunn, 2003; Dunn, 2003). to help its casino salespeople connect to top customers on a more personal basis. Working from a prioritized list of customer names displayed on a computer screen, the salesperson clicks on a name to view relevant information about the customer, such as background and preferred casino activities. There's even a printed script that can be used to guide the conversation. Such a system isn't very helpful, however, to middle or top-level managers, who need systems to help them carry out their oversight and planning responsibilities. To design marketing programs, for instance, marketing managers rely on summary information gleaned from a dedicated customer-relationship management system. Let's look at some of the widely available information systems designed to support people at the operational and upper-management levels.

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15.4: Computer Networks and Cloud Computing

Learning Objectives

1. Describe the main systems for sharing information through networked computers.
2. Define cloud computing and identify its advantages and disadvantages.

Once it's grown beyond just a handful of employees, an organization needs a way of sharing information. Imagine a flower shop with twenty employees. The person who takes phone orders needs access to the store's customer list, as do the delivery person and the bookkeeper. Now, the store may have one computer and everyone could share it. It's more likely, however, that there are a number of computers (several for salespeople, one for delivery, and one for bookkeeping). In this case, everyone needs to be sure that customer records have been updated on all computers every time that a change is required.

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15.5: Data Communications Networks

Learning Objective

1. Explain how four networking technologies—the Internet, the World Wide Web, intranets, and extranets—make data communication possible.

In addition to using networks for information sharing within the organization, companies use networks to communicate and share information with those outside the organization. All this is made possible by data communication networks, which transmit digital data (numeric data, text, graphics, photos, video, and voice) from one computer to another using a variety of wired and wireless communication channels. Let's take a closer look at the networking technologies that make possible all this electronic communication—in particular, the *Internet* (including the *World Wide Web*), *intranets*, and *extranets*.

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15.6: Security Issues in Electronic Communication

Learning Objective

1. Identify and discuss challenges faced by companies engaged in e-commerce.

E-commerce has presented businesses with opportunities undreamt of only a couple of decades ago. But it also has introduced some unprecedented challenges. For one thing, companies must now earmark more than 5 percent of their annual IT budgets for protecting themselves against disrupted operations and theft due to computer crime and sabotage (Alexander, 2011). The costs resulting from cyber crimes—criminal activity done using computers or the Internet—are substantial and increasing at an alarming rate. A 2010 study of forty-five large U.S. companies revealed that the median cost of cybercrime for the companies in the study was \$3.8 million a year (Ponemon, 2010). And some cybercrimes involve viruses that can spread rapidly from computer to computer creating enormous damage. It's estimated, for example, that damage to 50,000 personal computers and corporate networks from the so-called Blaster worm in August 2003 totaled \$2 billion, including \$1.2 billion paid by Microsoft to correct the problem (Shukovsky, 2011). The battle against technology crime is near the top of the FBI's list of priorities, behind only the war against terrorism and espionage (Alexander, 2011). In addition to protecting their own operations from computer crime, companies engaged in e-commerce must clear another hurdle: they must convince consumers that it's safe to buy things over the Internet—that credit-card numbers, passwords, and other personal information are protected from theft or misuse. In this section, we'll explore some of these challenges and describe a number of the efforts being made to meet them.

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15.7: Careers in Information Management

Learning Objective

1. Identify career opportunities in information management.

The number and variety of opportunities in the IS field have grown substantially as organizations have expanded their use of IT. In most large organizations, the senior management team includes a *chief information officer (CIO)* who oversees information and telecommunications systems. A large organization might also have a *chief technology officer* who reports to the CIO and oversees IT planning and implementation.

Most entry-level IS jobs require a business degree with a major in information systems. Many people supplement their IS majors with minors in computer science or some other business area, such as accounting, finance, marketing, or operations management.

If you're starting out with an IS degree, you may choose to follow either a management path or a technical path. At Kraft Foods, for example, IS professionals can focus on one of two areas: applications development (a management focus) and information technology (a technology focus). "Applications development," according to the company itself, "calls for an ability to analyze [Kraft's] clients' needs and translate them into systems applications. Information technology calls for the ability to convert business systems specifications into technical specifications and to provide guidance and technical counsel to other Kraft professionals" (Kraft Foods, 2006). Despite the differences in focus, Kraft encourages IS specialists to develop expertise in both areas. After all, it's the ability to apply technical knowledge to business situations that makes IS professionals particularly valuable to organizations. (By the way, if you want a career in casinos, you can major in casino management at a number of business schools.)

Key Takeaways

- The number and variety of opportunities in the information systems (IS) field have grown substantially as companies have expanded their use of information technology.
- The senior management team in large organizations includes a chief information officer who oversees information and a chief technology officer who oversees IT planning and implementation.
- Most entry-level IS jobs require a business degree with a major in information systems.
- Many supplement their IS majors with computer science or some other business area, such as accounting, finance, marketing, or operations management.
- Those entering organizations with IS degrees may choose to follow either a management or a technology path.

Exercise

(AACSB) Reflective Skills

Why is studying IT important to you as a student? How will competency in this area help you get and keep a job in the future?

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15.8: Cases and Problems

Learning on the Web

Taking Care of Your Cyber Health

It seems that some people have nothing better to do than wreak havoc by spreading computer viruses, and as a computer user, you should know how to protect yourself from malicious tampering. One place to start is by reading the article “How Computer Viruses Work,” by Marshall Brain, which you can access by going to the How Stuff Works Web site (<http://computer.howstuffworks.com/virus.htm>). After reading the article, answer the following questions:

1. Why do people create viruses?
2. What can you do to protect yourself against viruses?

Career Opportunities

Could You Manage a Job in IT or IS?

Do you have an aptitude for dealing with IT? Would you enjoy analyzing the information needs of an organization? Are you interested in directing a company’s Internet operations or overseeing network security? If you answered yes to any of these questions, then a career in IT and IS might be for you. Go to the U.S. Department of Labor Web site (www.bls.gov/oco/ocos258.htm) and learn more about the nature of the work, qualifications, and job outlook in IT and IS management. Bearing in mind that many people who enter the IT field attain middle-management positions, look for answers to the following questions:

1. What kinds of jobs do IT managers perform?
2. What educational background, work experience, and skills are needed for positions in IT management?
3. What’s the current job outlook for IS and IT managers? What factors drive employment opportunities?
4. What’s the median annual income of a mid-level IT manager?

Ethics Angle (AACSB)

Campus Commando or Common Criminal?

Do you want to be popular (or at least more prominent) on campus? You could set up a Web site that lets fellow students share music files over the campus network. All you have to do is seed the site with some of your own downloaded music and let the swapping begin. That’s exactly what Daniel Peng did when he was a sophomore at Princeton. It was a good idea, except for one small hitch: it was illegal, and he got caught. Unimpressed with Peng’s technological ingenuity, the Recording Industry Association of America (RIAA) sued him, and he was forced to settle for \$15,000. Instead of delivering music, Peng’s Web site now asks visitors to send money to help defray the \$15,000 and another \$8,000 in legal costs.

To learn more about the case, read these articles from the Daily Princetonian: “Peng, RIAA Settle Infringement Case” (www.dailyprincetonian.com/2003/05/02/8154/), and “Peng ’05 Sued by Recording Industry for ‘Wake’ Site” (www.dailyprincetonian.com/2003/04/04/7791/).

After researching the topic, answer the following questions:

1. The practice of sharing commercial music files is illegal. Do you think that it’s also unethical? Why, or why not?
2. What steps to curb the practice are being taken by the music industry? By college administrators? By the government? Do you approve of these steps? Have they been effective?
3. What, ultimately, do you see as the solution to the problem?

Source: Josh Brodie, “Peng, RIAA Settle Infringement Case,” *The Daily Princetonian*, www.dailyprincetonian.com/2003/05/02/8154/ (accessed November 14, 2011); Zachary Goldfarb and Josh Brodie, “Peng ’05 Sued by Recording Industry for ‘Wake’ Site,” *The Daily Princetonian* www.dailyprincetonian.com/2003/04/04/7791/ (accessed November 14, 2011).

Team-Building Skills (AACSB)

CampusCupid.com

It's no secret that college can be fun. For one thing, you get to hang around with a bunch of people your own age. Occasionally, you want to spend time with just one special someone, but finding that special person on a busy campus can take some of the fun out of matriculating. Fortunately, you're in the same love boat with a lot of other people, so one possible solution—one that meshes nicely with your desire to go into business—is to start an online dating service that caters to your school. Inasmuch as online dating is nothing new, you can do some preliminary research. For example, go to the Internetnews Web site (<http://www.internetnews.com/ec-news/article.php/2228891/Online+Personals+Big+Profits+Intense+Competition.htm>) and read the article "Online Personals: Big Profits, Intense Competition."

Next, you and several of your classmates should work as a team to create a business model for an online dating service at your school. After working out the details, submit a group report that covers the following issues:

1. *Services.* How will you earn revenues? What services will you offer? How will you price these services? What forms of payment will you accept? Will you sell ads? If so, what kinds?
2. *Appearance.* What will your site look like? Will it have graphics? Sound? Video? What will your domain name be? What information will you collect from customers? What information will you provide to visitors?
3. *Operations.* What criteria will you use to match customers? How will your customers interface with the Web site? How will they connect with each other? Will you design your own software or buy or lease it from vendors? Before you answer, go to these vendors' Web sites and check out their dating software:
 - WebDate (www.webscribble.com/products/...te/index.shtml)
 - PG Dating (www.datingpro.com/dating)
4. *Attracting Customers.* How will you attract customers to the site? How will you monitor and analyze site activity?
5. *Security.* How will you guarantee confidentiality? How will you ensure that your site is secure? How will you limit access to students at your school?
6. *Opportunities and Challenges.* What opportunities do e-businesses offer? What challenges do they create? How would your business model change if you decided to run it as a traditional business rather than as an e-business?

The Global View (AACSB)

"Hong Kong—Traditional Chinese"

Hewlett-Packard (HP) provides technology solutions to individuals, businesses, and institutions around the world. It generates annual revenues of \$80 billion from the sale of IT products, including computers, printers, copiers, digital photography, and software. Anyone in the United States who wants to buy an HP product, get technical support, download software, learn about the company, or apply for a job can simply go to the HP Web site. But what if you live in Hong Kong? How would you get answers to your questions? You'd do the same thing as people in this country do—go to HP's Web site.

Try to imagine, however, the complex process of developing and maintaining a Web site that serves the needs of customers in more than seventy countries. To get a better idea, go to the HP Web site (www.hp.com). Start by looking at HP's line of notebooks and checking its prices. Then, review the company information (click on "About HP" in the bottom right) that's posted on the site, and, finally, look for a job—it's good practice (click on "Jobs" in the bottom right).

Now pretend that you live in Hong Kong and repeat the process. Start by going to the same HP Web site (www.hp.com). Click on the United States (next to U.S. flag in the bottom left) and then Asia and Oceania. If you can read Chinese, click on "Hong Kong—Traditional Chinese." Otherwise, click on "Hong Kong—English." Then, answer the following questions:

1. How easy was it to navigate the site and to switch back and forth between the U.S. and Hong Kong sections of the site?
2. Identify at least five differences between the two sections.
3. Does HP's Web site meet the needs of customers in both the United States and Hong Kong? Why, or why not? How could it be improved?

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CHAPTER OVERVIEW

16: The Legal and Regulatory Environment of Business

- 16.1: Law and the Legal System
- 16.2: Criminal versus Civil Law
- 16.3: Negligence Torts
- 16.4: Product Liability
- 16.5: Some Principles of Public Law
- 16.6: Cases and Problems

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16.1: Law and the Legal System

Learning Objectives

1. Define *law* and explain how it differs from a *legal system*.
2. Explain the concept of the *rule of law* and discuss the role of *flexibility* and *fairness* in a legal system governed by the rule of law.
3. Discuss the primary functions of law in the United States.

In the eighteenth century, when the legal and regulatory environment of everything was a lot simpler than it is today, the great Irish satirist Jonathan Swift likened laws to cobwebs because they seem to stretch in every direction to catch innocent flies while failing utterly to stop wasps and other creatures responsible for much greater crimes against human comfort. Like George McGovern, many people no doubt find this comparison at least as true today as it was in Swift's time. After all, in order to be law-abiding innkeepers (or just plain citizens), we must negotiate a vast web of constitutional law, federal law, regulatory law, and state and local law; criminal law, civil law, and common law; substantive law and procedural law; public law and private law; and business law, which includes contract law, product-liability law, patent law, consumer-protection law, environmental law, employment and labor law, insurance law, cyberlaw, agency law, and a host of other forms of law. In fact, being a truly law-abiding citizen is virtually out of the question. According to one estimate, the average American driver deserves ten speeding tickets a day. Other underpenalized violations range from stealing cable TV and scalping tickets to exhibitionism and illegal fishing and hunting (Sexton, 2008).

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16.2: Criminal versus Civil Law

Learning Objectives

1. Distinguish between *criminal law* and *civil law*, and understand the roles of *plaintiffs* and *defendants* in both criminal and civil cases.
2. Define a *tort*, explain *tort law*, and discuss an *intentional tort*.

In the case of George McGovern and his Stratford Inn, we saw what sort of legal entanglements could discourage even a veteran lawmaker from pursuing a modest dream of business ownership. What about you? How easily discouraged would you be? Put yourself in the following scenario, which could happen to anybody:

When you were in high school, you worked part time and over the summers for your father, a house painter. Now that you're in college, you've decided to take advantage of that experience to earn some money during your summer vacation. You set yourself up as a house-painting business and hire your college roommate to help you out. One fine summer day, the two of you are putting a coat of Misty Meadow acrylic latex on the exterior of a two-story Colonial. You're working on the ground floor around the door of the house while your roommate is working from scaffolding over the garage. Looking up, you notice that, despite several warnings, your roommate has placed his can of paint at his feet rather than fixed it to the ladder bracing the platform. You're about to say something yet one more time, but it's too late: He accidentally kicks the bucket (so to speak), which bounces off the homeowner's red sports car, denting the hood and splattering it with Misty Meadow. As luck would have it, the whole episode is witnessed by the homeowner's neighbor, who approaches the scene of the disaster just as your roommate has climbed down from the scaffold. "Man, you must be dumber than a bag of hammers," says the neighbor to your roommate, who's in no mood for unsolicited opinions, and before you know what's happening, he breaks the neighbor's nose with a single well-placed punch.

The homeowner sues you and your roommate for negligence, and the neighbor sues you and your roommate for assault and battery (Moran, 2008).

Clearly, being an employer—even of just one person—isn't nearly as simple as you thought it would be. What should you have known about the basics of *employment law* in the state where you intended to paint houses? What should you have known about *tort law*? What about *tax law*? If you have to pay damages as a result of the homeowner's negligence claim, can you at least deduct them as business expenses?

Welcome to the *legal environment of business*—the place where business interacts with the legal system. Besides the fact that these interactions are usually quite complicated, what valuable lessons should you learn from your experience once your case has been *adjudicated* (resolved in court)? You probably won't be surprised to learn that your roommate is liable for negligence in kicking over the paint bucket, but you may be dismayed to learn that you are, too. When it comes to the claim of assault and battery, your roommate is also liable for that, but you may be protected from liability. As for the damages that you'll probably have to pay in order to settle the homeowner's negligence suit, you'll be pleased to learn that you can indeed write them off as "ordinary" business expenses (unless they're paid by your insurance company).

As we work our way through this chapter, we'll look a little more closely at the types of law involved in your case, but we'll start by observing that, in at least one respect, your roommate's predicament can be more instructive than yours. That's because assault and battery violates statutes established by two different types of law—*criminal* and *civil*.

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16.3: Negligence Torts

Learning Objectives

1. Define a *negligence tort* and discuss the elements of a negligence claim.
2. Explain a *contract* and discuss the requirements of an enforceable contract.
3. Explain the concepts of *respondeat superior* and *scope of employment* and discuss their roles in an employment contract.

We can now get back to your role in this case, though doing so means first taking a closer look at further aspects of your roommate's role. You and your roommate are being sued by the homeowner for a different type of tort—a negligence tort, which results not from intentional wrongdoing, but from *carelessness*. When he placed that can of paint at his feet, where he might easily dislodge it as he moved around the platform, your roommate allowed his conduct to fall below a certain standard of care—namely, the degree of care necessary to protect others from an unreasonable likelihood of harm.

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16.4: Product Liability

Learning Objectives

1. Define *product liability* and discuss the three grounds, or “theories of recovery,” for a claim of product liability.
2. Discuss the three forms of manufacturer’s negligence that may be claimed in a product-liability case.
3. Define *strict liability* and explain the *doctrine of strict liability in tort*.
4. Define a *warranty* and distinguish between *express warranties* and *implied warranties*.
5. Identify the primary goal of tort law and distinguish between *compensatory damages* and *punitive damages*.

In addition to intentional and negligence torts, U.S. law recognizes a third category of torts: strict liability torts involve actions that are inherently dangerous and for which a party may be liable no matter how carefully he or she (or it) performs them. To better appreciate the issues involved in cases of strict liability, let’s take up the story of your legal adventures in the world of business where we left off:

Having escaped the house-painting business relatively unscathed, you head back home to rethink your options for gainful employment over your summer vacation. You’ve stored your only remaining capital assets—the two ladders and the platform that you’d used for scaffolding—in your father’s garage, where one afternoon, your uncle notices them. Examining one of the ladders, he asks you how much weight it’s designed to hold, and you tell him what the department manager at Ladders ’N’ Things told you—three hundred pounds per rung. He nods as if this is a good number, and, sensing that he might want to buy them, you hasten to add that though you got them at a cut-rate price because of a little rust, they’re virtually brand-new. As it turns out, he doesn’t want to buy them, but he does offer to pay you \$35 an hour to take them to his house and help him put up new roofing. He’s easygoing, he’s family, and he probably won’t sue you for anything, so you jump at the opportunity.

Everything goes smoothly until day two, when you’re working on the scaffolding two stories off the ground. As you’re in the process of unwrapping a bundle of shingles, one of the ladders buckles, bringing down the platform and depositing you on your uncle’s stone patio with a cervical fracture.

Fortunately, there’s no damage to your spinal cord, but you’re in pain and you need surgery. Now it’s your turn to sue somebody. But whom? And for what?

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16.5: Some Principles of Public Law

Learning Objectives

1. Explain the difference between *private law* and *public law*.
2. Define *statutory law* and give examples of statutory laws at various governmental levels.
3. Explain *externalities* and show why taxation is used as a means of addressing them.
4. Discuss the idea of *market failure* and the principle of *efficiency* as a foundation of law.
5. Define *administrative law* and discuss the role of federal *administrative agencies* in making and enforcing administrative laws.
6. Define *case law* and explain the concepts of *precedent* and *judicial review*.

Both tort law and contract law fall into the larger domain of private law, which deals with private relationships among individuals and organizations. In addition, of course, there are numerous types of law that deal with the relationship of government to private individuals and other private entities, including businesses. This is the area of public law, which falls into three general categories (Kubasek, 2009):

- *Criminal law*, which we've already introduced, prohibits and punishes wrongful conduct.
- *Constitutional law* concerns the laws and basic legal principles set forth by the U.S. Constitution.
- *Administrative law* refers to statutes and regulations related to the activities of certain legal bodies known as *administrative agencies*. We'll have more to say about administrative agencies and administrative law later in the chapter.

Public law obviously has a major impact on the activities of both individuals and businesses in the United States, and in the following section, we'll discuss the nature of this impact and the reasons why so many private activities are subject to the rules and principles of public law. Like most areas of the law, public law is an extremely complex field of study, and to keep things manageable we're going to explore this field by focusing on three less-than-glamorous legal issues: *why cigarette littering is against the law*, *why cigarettes cost so much*, and *why businesses ban smoking in the workplace*.

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16.6: Cases and Problems

Career Opportunities

Would You Like to Be a Lawyer?

Are you interested in a career in law? To learn what lawyers do, read the article on About.com, “Lawyer” by Sally Kane, <http://legalcareers.about.com/od/careers/p/Lawyer.htm>

As a follow-up (and because getting a job is a good thing), read a second article on About.com, “Who Hires Lawyers?” by Tara Kuther, <http://gradschool.about.com/od/lawsc.../f/lawjobs.htm>. Then, answer the following questions, being sure to provide an explanation for each of your answers:

- What about being a lawyer interests you?
- What might discourage you from pursuing a career in law?
- Overall, does a career in law appeal to you? Why, or why not?

Ethics Angle (AACSB)

The Product Liability Debate

The article “Who Should Pay? The Product Liability Debate,” by Claire Andre and Manuel Velasquez, provides the pros and cons of the current product liability legal environment. Read the article, which can be found at www.scu.edu/ethics/publications/v4n1/pay.html, and answer these questions:

1. Should consumers bear more responsibility for product injuries?
2. Should drug manufacturers bear more responsibility?
3. Is the current product-liability legal system broken? Why, or why not? If you believe it is broken, how would you fix it?

Team-Building Skills (AACSB)

Get together as a team and debate these two related issues: “How much should a pack of cigarettes cost?” and “Should businesses ban smoking the workplace?” Write a “position” paper explaining your group’s opinion. If the group doesn’t reach an agreement on the issues, include a “minority report”—the opinion of a minority of the group.

The Global View (AACSB)

What issues would you encounter as a businessperson negotiating a sales contract with a company in China? How would you overcome these issues?

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Glossary

absolute advantage | Condition whereby a country is the only source of a product or is able to make more of a product using the same or fewer resources than other countries.

account payable | Record of cash owed to sellers from whom a business has purchased products on credit.

account receivable | Record of cash that will be received from a customer to whom a business has sold products on credit.

Accountants | Financial advisor responsible for measuring, summarizing, and communicating financial and managerial information.

Accountants | Financial advisor responsible for measuring, summarizing, and communicating financial and managerial information.

accounting | System for measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.

accounting | System for measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.

accounting equation | Accounting tool showing the resources of a business (assets) and the claims on those resources (liabilities and owner's equity).

accounting equation | Accounting tool showing the resources of a business (assets) and the claims on those resources (liabilities and owner's equity).

accrual accounting | Accounting system that records transactions when they occur, regardless of when cash is paid or received.

accrual accounting | Accounting system that records transactions when they occur, regardless of when cash is paid or received.

acquisition | The purchase of one company by another with no new company being formed.

acquisition | The purchase of one company by another with no new company being formed.

adjustable-rate mortgage (ARM) | Mortgage that's pegged to the increase or decrease of certain interest rates that your lender has to pay.

adjustable-rate mortgage (ARM) | Mortgage that's pegged to the increase or decrease of certain interest rates that your lender has to pay.

administrative law | Body of law dealing with statutes and regulations related to the activities of administrative agencies.

Advertising | Paid, nonpersonal communication designed to create an awareness of a product or company.

Advertising | Paid, nonpersonal communication designed to create an awareness of a product or company.

advertising agency | Marketing consulting firm that develops and executes promotional campaigns for clients.

advertising agency | Marketing consulting firm that develops and executes promotional campaigns for clients.

agency | Legal relationship in which one party acts on behalf of, and under the control of, another.

agency | Legal relationship in which one party acts on behalf of, and under the control of, another.

American Stock Exchange (AMEX) | Stock market where shares of smaller companies are traded.

American Stock Exchange (AMEX) | Stock market where shares of smaller companies are traded.

amortization | Schedule by which you'll reduce the balance of your debt.

amortization | Schedule by which you'll reduce the balance of your debt.

application | Document completed by a job applicant that provides factual information on the person's education and work background.

application | Document completed by a job applicant that provides factual information on the person's education and work background.

applications software | Software that performs a specific task, such as word processing or spreadsheet creation.

applications software | Software that performs a specific task, such as word processing or spreadsheet creation.

arbitration | Process of resolving a labor-contract dispute by having a third party study the situation and arrive at a *binding* agreement.

arbitration | Process of resolving a labor-contract dispute by having a third party study the situation and arrive at a *binding* agreement.

Artificial intelligence | Science of developing computer systems that can mimic human behavior.

Artificial intelligence | Science of developing computer systems that can mimic human behavior.

assets | Resource from which a business expects to gain some future benefit.

assets | Resource from which a business expects to gain some future benefit.

audits | Accountant's examination of and report on a company's financial statements.

audits | Accountant's examination of and report on a company's financial statements.

balance of payments | Difference between the total flow of money coming into a country and the total flow of money going out.

balance of payments | Difference between the total flow of money coming into a country and the total flow of money going out.

balance sheet | Report on a company's assets, liabilities, and owner's equity at a specific point in time.

balance sheet | Report on a company's assets, liabilities, and owner's equity at a specific point in time.

bear market | Period of declining or sluggish stock prices.

bear market | Period of declining or sluggish stock prices.

behavioral segmentation | Process of dividing consumers by behavioral variables, such as attitude toward the product, user status, or usage rate.

behavioral segmentation | Process of dividing consumers by behavioral variables, such as attitude toward the product, user status, or usage rate.

benchmarking | Practice of comparing a company's own performance with that of a company that excels in the same activity.

benchmarking | Practice of comparing a company's own performance with that of a company that excels in the same activity.

benefits | Compensation other than salaries, hourly wages, or financial incentives.

benefits | Compensation other than salaries, hourly wages, or financial incentives.

blocking roles | Behavior that inhibits either team performance or that of individual members.

blocking roles | Behavior that inhibits either team performance or that of individual members.

bonds | Debt securities that require annual interest payments to bondholders.

bonds | Debt securities that require annual interest payments to bondholders.

bonuses | Annual income given to employees (in addition to salary) based on company-wide performance.

bonuses | Annual income given to employees (in addition to salary) based on company-wide performance.

boycotting | Method used by union members to voice displeasure with certain organizations by refusing to buy the company's products and encouraging others to follow suit.

boycotting | Method used by union members to voice displeasure with certain organizations by refusing to buy the company's products and encouraging others to follow suit.

brand loyalty | Consumer preference for a particular brand that develops over time based on satisfaction with a company's products.

brand loyalty | Consumer preference for a particular brand that develops over time based on satisfaction with a company's products.

breakeven analysis | Method of determining the level of sales at which the company will break even (have no profit or loss).

breakeven analysis | Method of determining the level of sales at which the company will break even (have no profit or loss).

breakeven analysis | Method of determining the level of sales at which the company will break even (have no profit or loss).

breakeven analysis | Method of determining the level of sales at which the company will break even (have no profit or loss).

breakeven point in units | Number of sales units at which net income is zero.

breakeven point in units | Number of sales units at which net income is zero.

breakeven point in units | Number of sales units at which net income is zero.

browsers | Software (such as Internet Explorer) that locates and displays Web pages.

browsers | Software (such as Internet Explorer) that locates and displays Web pages.

budget | A document that itemizes the sources of income and expenditures for a future period (often a year).

budget | A document that itemizes the sources of income and expenditures for a future period (often a year).

business cycle | Pattern of expansion and contraction in an economy.

business cycle | Pattern of expansion and contraction in an economy.

business ethics | Application of ethical behavior in a business context.

business ethics | Application of ethical behavior in a business context.

business plan | Formal document describing a proposed business concept, description of the proposed business, industry analysis, mission statement and core values, a management plan, a description of goods or services, a description of production processes, and marketing and financial plans.

business plan | Formal document describing a proposed business concept, description of the proposed business, industry analysis, mission statement and core values, a management plan, a description of goods or services, a description of production processes, and marketing and financial plans.

capacity | Maximum number of products that a facility can produce over a given period under normal working conditions.

capacity | Maximum number of products that a facility can produce over a given period under normal working conditions.

capital budget | Budget that shows anticipated expenditures for major equipment.

capital budget | Budget that shows anticipated expenditures for major equipment.

capital structure | Relationship between a company's debt (funds acquired from creditors) and its equity (funds invested by owners).

capital structure | Relationship between a company's debt (funds acquired from creditors) and its equity (funds invested by owners).

capitalism | Economic system featuring the lowest level of government control over allocation and distribution.

capitalism | Economic system featuring the lowest level of government control over allocation and distribution.

Cash-flow management | Process of monitoring cash inflows and outflows to ensure that the company has the right amount of funds on hand.

Cash-flow management | Process of monitoring cash inflows and outflows to ensure that the company has the right amount of funds on hand.

cash-flow or income statement | Shows where your money has come from and where it's slated to go.

cash-flow or income statement | Shows where your money has come from and where it's slated to go.

cellular layout | Layout in which teams of workers perform all the tasks involved in building a component, group of related components, or finished product.

cellular layout | Layout in which teams of workers perform all the tasks involved in building a component, group of related components, or finished product.

certificate authority | Third-party (such as VeriSign) that verifies the identify of a computer site.

certificate authority | Third-party (such as VeriSign) that verifies the identify of a computer site.

chain of command | Authority and reporting relationships among people working at different levels of an organization.

chain of command | Authority and reporting relationships among people working at different levels of an organization.

civil law | Body of law governing disputes between private parties.

civil law | Body of law governing disputes between private parties.

classified balance sheet | Balance sheet that totals assets and liabilities in separate categories.

classified balance sheet | Balance sheet that totals assets and liabilities in separate categories.

client-server systems | System connecting client machines (which are used by employees for data input and retrieval) and a server (that stores shared databases and programs).

client-server systems | System connecting client machines (which are used by employees for data input and retrieval) and a server (that stores shared databases and programs).

cloud computing | Cloud computing means performing computer tasks using services provided over the Internet.

cloud computing | Cloud computing means performing computer tasks using services provided over the Internet.

code of conduct | Statement that defines the principles and guidelines that employees must follow in the course of all job-related activities.

code of conduct | Statement that defines the principles and guidelines that employees must follow in the course of all job-related activities.

collective bargaining | Process by which management and union-represented workers settle differences.

collective bargaining | Process by which management and union-represented workers settle differences.

Commercial banks | Financial institution that generates profits by lending funds and providing customers with services, such as check processing.

Commercial banks | Financial institution that generates profits by lending funds and providing customers with services, such as check processing.

commission | Compensation paid to employees based on the dollar amount of sales that they make.

commission | Compensation paid to employees based on the dollar amount of sales that they make.

common stock | Stock whose owners bear the ultimate rewards and risks of ownership.

common stock | Stock whose owners bear the ultimate rewards and risks of ownership.

communication | Process of transferring information from a sender to a receiver.

communication | Process of transferring information from a sender to a receiver.

communism | Economic system featuring the highest level of government control over allocation and distribution.

communism | Economic system featuring the highest level of government control over allocation and distribution.

comparative advantage | Condition whereby one nation is able to produce a product at a lower opportunity cost compared to another nation.

comparative advantage | Condition whereby one nation is able to produce a product at a lower opportunity cost compared to another nation.

comparative income statement | Financial statement showing income for more than one year.

comparative income statement | Financial statement showing income for more than one year.

compensatory damages | Monetary awards intended to restore tort victims to the conditions that they would have been in had their injuries never taken place.

compensatory damages | Monetary awards intended to restore tort victims to the conditions that they would have been in had their injuries never taken place.

compound interest | Interest earned on your savings is added to the money in your savings account, and the new total (principle plus interest) earns more interest.

compound interest | Interest earned on your savings is added to the money in your savings account, and the new total (principle plus interest) earns more interest.

computer-aided design (CAD) | System using computer technology to create models representing the design of a product.

computer-aided design (CAD) | System using computer technology to create models representing the design of a product.

computer-aided manufacturing (CAM) | System using computer technology to control production processes and equipment.

computer-aided manufacturing (CAM) | System using computer technology to control production processes and equipment.

conceptual skills | Skills used to reason abstractly and analyze complex situations.

conceptual skills | Skills used to reason abstractly and analyze complex situations.

Conflicts of interest | Situation in which an individual must choose between the promotion of personal interests and the interests of others.

Conflicts of interest | Situation in which an individual must choose between the promotion of personal interests and the interests of others.

consumer behavior | Decision process that individuals go through when purchasing or using products.

consumer behavior | Decision process that individuals go through when purchasing or using products.

consumer confidence index | Measure of optimism that consumers express about the economy as they go about their everyday lives.

consumer confidence index | Measure of optimism that consumers express about the economy as they go about their everyday lives.

consumer market | Buyers who want a product for personal use.

consumer market | Buyers who want a product for personal use.

consumer price index (CPI) | Index that measures inflation by measuring the prices of goods purchased by a typical consumer.

consumer price index (CPI) | Index that measures inflation by measuring the prices of goods purchased by a typical consumer.

contingency planning | Process of identifying courses of action to be taken in the event that a business is adversely affected by a change.

contingency planning | Process of identifying courses of action to be taken in the event that a business is adversely affected by a change.

contingent workers | Temporary or part-time worker hired to supplement a company's permanent workforce.

contingent workers | Temporary or part-time worker hired to supplement a company's permanent workforce.

continuous improvement | Company's commitment to making constant improvements in the design, production, and delivery of its products.

continuous improvement | Company's commitment to making constant improvements in the design, production, and delivery of its products.

contract | Exchange of promises or exchange of a promise for an act.

contract | Exchange of promises or exchange of a promise for an act.

contribution margin per unit | Excess of revenue per unit over variable cost per unit.

contribution margin per unit | Excess of revenue per unit over variable cost per unit.

contribution margin per unit | Excess of revenue per unit over variable cost per unit.

contribution margin per unit | Excess of revenue per unit over variable cost per unit.

controlling | Management process of comparing actual to planned performance and taking corrective actions when necessary.

controlling | Management process of comparing actual to planned performance and taking corrective actions when necessary.

convertible preferred stock | Preferred stock that gives its owner the option of exchanging it for common stock.

convertible preferred stock | Preferred stock that gives its owner the option of exchanging it for common stock.

cooperative | A business owned and controlled by those who use its services.

cooperative | A business owned and controlled by those who use its services.

Core values | Statement of fundamental beliefs describing what's appropriate and important in conducting organizational activities and providing a guide for the behavior of organization members.

Core values | Statement of fundamental beliefs describing what's appropriate and important in conducting organizational activities and providing a guide for the behavior of organization members.

Corporate social responsibility | Approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economic, ethical, and social decisions.

Corporate social responsibility | Approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economic, ethical, and social decisions.

corporation | Legal entity that is entirely separate from the parties who own it and that is responsible for its own debts.

corporation | Legal entity that is entirely separate from the parties who own it and that is responsible for its own debts.

cost-based pricing | Pricing strategy that bases the selling price of a product on its cost plus a reasonable profit.

cost-based pricing | Pricing strategy that bases the selling price of a product on its cost plus a reasonable profit.

cover letter | A document accompanying your résumé that explains why you're sending your résumé and highlights your qualifications.

cover letter | A document accompanying your résumé that explains why you're sending your résumé and highlights your qualifications.

credit union | Financial institution that provides services to only its members (who are associated with a particular organization).

credit union | Financial institution that provides services to only its members (who are associated with a particular organization).

crisis management | Action plans that outline steps to be taken by a company in case of a crisis.

crisis management | Action plans that outline steps to be taken by a company in case of a crisis.

cross-functional teams | Team designed to take advantage of the special expertise of members drawn from different functional areas of the organization.

cross-functional teams | Team designed to take advantage of the special expertise of members drawn from different functional areas of the organization.

Cultural barriers | Barriers that result from differences among people of different cultures.

Cultural barriers | Barriers that result from differences among people of different cultures.

culture | System of shared beliefs, values, customs, and behaviors that govern the interactions of members of a society.

culture | System of shared beliefs, values, customs, and behaviors that govern the interactions of members of a society.

current ratio | Financial ratio showing the relationship between a company's current assets and current liabilities.

current ratio | Financial ratio showing the relationship between a company's current assets and current liabilities.

customer division | Organizational structure that groups employees into customer-based business segments.

customer division | Organizational structure that groups employees into customer-based business segments.

customer value triad | Three factors that customers consider in determining the value of a product: quality, service, and price.

customer value triad | Three factors that customers consider in determining the value of a product: quality, service, and price.

customer-relationship management | Strategy for retaining customers by gathering information about them, understanding them, and treating them well.

customer-relationship management | Strategy for retaining customers by gathering information about them, understanding them, and treating them well.

data communication networks | Large network used to transmit digital data from one computer to another using a variety of wired and wireless communication channels.

data communication networks | Large network used to transmit digital data from one computer to another using a variety of wired and wireless communication channels.

data mining | Technique used to search and analyze data to reveal patterns and trends that can be used to predict future behavior.

data mining | Technique used to search and analyze data to reveal patterns and trends that can be used to predict future behavior.

data warehouse | Centralized database that stores data from several databases so they can be easily analyzed.

data warehouse | Centralized database that stores data from several databases so they can be easily analyzed.

databases | Electronic collection of related data accessible to various users.

databases | Electronic collection of related data accessible to various users.

debit card | Pulls money out of your checking account whenever you use the card to buy something or get cash from an ATM.

debit card | Pulls money out of your checking account whenever you use the card to buy something or get cash from an ATM.

decentralization | Decision-making process in which most decision making is spread throughout the organization.

decentralization | Decision-making process in which most decision making is spread throughout the organization.

decision support system | Interactive system that extracts, integrates, and displays data from multiple sources to help managers make nonroutine decisions.

decision support system | Interactive system that extracts, integrates, and displays data from multiple sources to help managers make nonroutine decisions.

decision-making skills | Skills used in defining a problem, analyzing possible solutions, and selecting the best outcome.

decision-making skills | Skills used in defining a problem, analyzing possible solutions, and selecting the best outcome.

defendant | Party charged in a legal complaint; in criminal law, party against whom a criminal charge is brought; in civil law, party being sued for compensation for wrong allegedly done to plaintiff.

defendant | Party charged in a legal complaint; in criminal law, party against whom a criminal charge is brought; in civil law, party being sued for compensation for wrong allegedly done to plaintiff.

defined contribution retirement plan | A form of retirement savings plan in which both the employee and the employer may contribute.

defined contribution retirement plan | A form of retirement savings plan in which both the employee and the employer may contribute.

deflation | Decrease in overall price level.

deflation | Decrease in overall price level.

delegation | Process of entrusting work to subordinates.

delegation | Process of entrusting work to subordinates.

Demand | Quantity of a product that buyers are willing to purchase at various prices.

Demand | Quantity of a product that buyers are willing to purchase at various prices.

demand curve | Graph showing the quantity of a product that will be bought at certain prices.

demand curve | Graph showing the quantity of a product that will be bought at certain prices.

demand deposits | Checking accounts that pay given sums to "payees" when they demand them.

demand deposits | Checking accounts that pay given sums to "payees" when they demand them.

demand-based pricing | Pricing strategy that bases the price of a product on how much people are willing to pay for it.

demand-based pricing | Pricing strategy that bases the price of a product on how much people are willing to pay for it.

Demographic segmentation | Process of dividing the market into groups based on such variables as age and income.

Demographic segmentation | Process of dividing the market into groups based on such variables as age and income.

departmentalization | Process of grouping specialized jobs into meaningful units.

departmentalization | Process of grouping specialized jobs into meaningful units.

depreciation expense | Costs of a long-term or fixed asset spread over its useful life.

depreciation expense | Costs of a long-term or fixed asset spread over its useful life.

depression | Severe, long-lasting recession.

depression | Severe, long-lasting recession.

directing | Management process that provides focus and direction to others and motivates them to achieve organizational goals.

directing | Management process that provides focus and direction to others and motivates them to achieve organizational goals.

discount rate | Rate of interest the Fed charges member banks when they borrow reserve funds.

discount rate | Rate of interest the Fed charges member banks when they borrow reserve funds.

Distribution | All activities involved in getting the right quantity of a product to the right customer at the right time and at a reasonable cost.

Distribution | All activities involved in getting the right quantity of a product to the right customer at the right time and at a reasonable cost.

distribution center | Location where products are received from multiple suppliers, stored temporarily, and then shipped to their final destinations.

distribution center | Location where products are received from multiple suppliers, stored temporarily, and then shipped to their final destinations.

dividends | Earnings distributed to stockholders.

divisional organizations | Form of organization that groups people into several smaller, self-contained units, or divisions, which are accountable for their own performance.

divisional organizations | Form of organization that groups people into several smaller, self-contained units, or divisions, which are accountable for their own performance.

Dow Jones Industrial Average (DJIA) | Market index that reflects the total value of a "market basket" of thirty large U.S. companies.

Dow Jones Industrial Average (DJIA) | Market index that reflects the total value of a "market basket" of thirty large U.S. companies.

downsizing | Practice of eliminating jobs to cut costs.

downsizing | Practice of eliminating jobs to cut costs.

downward communication | Communication flow from higher to lower organizational levels.

downward communication | Communication flow from higher to lower organizational levels.

dumping | Practice of selling exported goods below the price that producers would normally charge home markets.

dumping | Practice of selling exported goods below the price that producers would normally charge home markets.

e-commerce | Business conducted over the Internet.

e-commerce | Business conducted over the Internet.

economic indicator | Statistic that provides information about trends in the economy.

economic indicator | Statistic that provides information about trends in the economy.

economic system | Means by which a society makes decisions about allocating resources to produce and distribute products.

economic system | Means by which a society makes decisions about allocating resources to produce and distribute products.

electronic data interchange | Computerized exchange of business transaction documents.

electronic data interchange | Computerized exchange of business transaction documents.

electronic data interchange (EDI) | Computerized exchange of business transaction documents.

electronic data interchange (EDI) | Computerized exchange of business transaction documents.

embargo | Extreme form of quota that bans the import or export of certain goods to a country for economic or political reasons.

embargo | Extreme form of quota that bans the import or export of certain goods to a country for economic or political reasons.

employment-at-will | Legal doctrine that allows an employer to fire an employee at will.

employment-at-will | Legal doctrine that allows an employer to fire an employee at will.

encryption | Process of encoding data so that only individuals or computers armed with a secret code (or key) can decode it.

encryption | Process of encoding data so that only individuals or computers armed with a secret code (or key) can decode it.

enterprise resource planning (ERP) system | Integrated computer system used to channel information to multiple users.

enterprise resource planning (ERP) system | Integrated computer system used to channel information to multiple users.

entrepreneur | Individual who identifies a business opportunity and assumes the risk of creating and running a business to take advantage of it.

entrepreneur | Individual who identifies a business opportunity and assumes the risk of creating and running a business to take advantage of it.

Equal Employment Opportunity Commission (EEOC) | Federal agency in charge of enforcing federal laws on employment discrimination.

Equal Employment Opportunity Commission (EEOC) | Federal agency in charge of enforcing federal laws on employment discrimination.

equilibrium price | Price at which buyers are willing to buy exactly the amount that sellers are willing to sell.

equilibrium price | Price at which buyers are willing to buy exactly the amount that sellers are willing to sell.

equity theory | Theory of motivation that focuses on our perceptions of how fairly we're treated relative to others.

equity theory | Theory of motivation that focuses on our perceptions of how fairly we're treated relative to others.

ethical dilemma | Morally problematic situation.

ethical dilemma | Morally problematic situation.

ethical lapse | Situation in which an individual makes a decision that's unmistakably unethical or illegal.

ethical lapse | Situation in which an individual makes a decision that's unmistakably unethical or illegal.

European Union (EU) | Association of European countries that joined together to eliminate trade barriers among themselves.

European Union (EU) | Association of European countries that joined together to eliminate trade barriers among themselves.

exchange rate | Value of one currency relative to another.

exchange rate | Value of one currency relative to another.

executive information system | System that provides senior managers with strategic information customized to meet their needs and presented in a convenient format.

executive information system | System that provides senior managers with strategic information customized to meet their needs and presented in a convenient format.

executive summary | Overview emphasizing the key points of a business plan to get the reader excited about the business's prospects.

executive summary | Overview emphasizing the key points of a business plan to get the reader excited about the business's prospects.

expectancy theory | Theory of motivation that proposes that employees will work hard to earn rewards they value and consider obtainable.

expectancy theory | Theory of motivation that proposes that employees will work hard to earn rewards they value and consider obtainable.

expenses | Costs incurred by selling products to customers.

expenses | Costs incurred by selling products to customers.

Expert systems | Program that mimics the judgment of experts.

Expert systems | Program that mimics the judgment of experts.

exporting | Practice of selling domestic products to foreign customers.

exporting | Practice of selling domestic products to foreign customers.

express warranty | Warranty created when a seller affirms that a product meets certain standards of quality, description, performance, or condition.

express warranty | Warranty created when a seller affirms that a product meets certain standards of quality, description, performance, or condition.

External communication | Channel through which communication occurs between parties inside a company and parties outside it.

External communication | Channel through which communication occurs between parties inside a company and parties outside it.

external marketing environment | Factors external to the firm that present threats and opportunities and that require shifts in marketing plans.

external marketing environment | Factors external to the firm that present threats and opportunities and that require shifts in marketing plans.

externalities | Cost that doesn't show up as part of the market price for a product.

externalities | Cost that doesn't show up as part of the market price for a product.

extranet | Intranet that's partially available to certain parties outside the organization.

extranet | Intranet that's partially available to certain parties outside the organization.

factors of production | Resources consisting of land, labor, capital (money, buildings, equipment), and entrepreneurial skills combined to produce goods and services.

factors of production | Resources consisting of land, labor, capital (money, buildings, equipment), and entrepreneurial skills combined to produce goods and services.

fair market value | The price you could get by selling assets at their present price.

fair market value | The price you could get by selling assets at their present price.

Federal Depository Insurance Corporation (FDIC) | Government agency that regulates banks and insures deposits in its member banks up to \$250,000.

Federal Depository Insurance Corporation (FDIC) | Government agency that regulates banks and insures deposits in its member banks up to \$250,000.

federal funds rate | The interest rate that a Federal Reserve member bank pays when it borrows from other member banks to meet reserve requirements.

federal funds rate | The interest rate that a Federal Reserve member bank pays when it borrows from other member banks to meet reserve requirements.

Federal Reserve System | U.S. central banking system, which has three goals: price stability, sustainable economic growth, and full employment.

Federal Reserve System | U.S. central banking system, which has three goals: price stability, sustainable economic growth, and full employment.

fiduciary responsibility | Duty of management to safeguard a company's assets and handle its funds in a trustworthy manner.

fiduciary responsibility | Duty of management to safeguard a company's assets and handle its funds in a trustworthy manner.

Finance | Activities involved in planning for, obtaining, and managing a company's funds.

Finance | Activities involved in planning for, obtaining, and managing a company's funds.

Finance companies | Nondeposit financial institution that makes loans from funds acquired by selling securities or borrowing from commercial banks.

Finance companies | Nondeposit financial institution that makes loans from funds acquired by selling securities or borrowing from commercial banks.

financial plan | Planning document that shows the amount of funds a company needs and details a strategy for getting those funds.

financial plan | Planning document that shows the amount of funds a company needs and details a strategy for getting those funds.

financial planning | The process of managing your personal finances to meet goals that you've set for yourself or your family.

financial planning | The process of managing your personal finances to meet goals that you've set for yourself or your family.

financing activities | Activity that creates cash inflows or outflows through the obtaining or repaying of borrowed or invested funds.

financing activities | Activity that creates cash inflows or outflows through the obtaining or repaying of borrowed or invested funds.

firewall | Software program that controls access to a company's intranet.

firewall | Software program that controls access to a company's intranet.

First-line managers | Those at the bottom of the management hierarchy who supervise employees and coordinate their activities.

First-line managers | Those at the bottom of the management hierarchy who supervise employees and coordinate their activities.

fiscal policy | Governmental use of taxation and spending to influence economic conditions.

fiscal policy | Governmental use of taxation and spending to influence economic conditions.

fiscal year | Company's designated business year.

fiscal year | Company's designated business year.

fixed costs | Costs that don't change when the amount of goods sold changes.

fixed costs | Costs that don't change when the amount of goods sold changes.

fixed costs | Costs that don't change when the amount of goods sold changes.

fixed costs | Costs that don't change when the amount of goods sold changes.

fixed-position layout | Layout in which workers are moved to the product, which stays in one place.

fixed-position layout | Layout in which workers are moved to the product, which stays in one place.

fixed-rate mortgage | A mortgage on which the interest rate remains the same regardless of changes in market interest rates.

fixed-rate mortgage | A mortgage on which the interest rate remains the same regardless of changes in market interest rates.

flexible manufacturing system | System in which computer-controlled equipment is programmed to handle materials used in manufacturing.

flexible manufacturing system | System in which computer-controlled equipment is programmed to handle materials used in manufacturing.

flexible manufacturing systems (FMS) | System in which computer-controlled equipment is programmed to handle materials used in manufacturing.

flexible manufacturing systems (FMS) | System in which computer-controlled equipment is programmed to handle materials used in manufacturing.

flexible spending account | Allows a specified amount of pretax dollars to be used to pay for qualified expenses, including health care and child care.

flexible spending account | Allows a specified amount of pretax dollars to be used to pay for qualified expenses, including health care and child care.

flextime | Alternative work arrangement that allows employees to designate starting and quitting times.

flextime | Alternative work arrangement that allows employees to designate starting and quitting times.

foreign subsidiary | Independent company owned by a foreign firm (called its parent).

foreign subsidiary | Independent company owned by a foreign firm (called its parent).

formal communication network | Network consisting of all communications that flow along an organization's official lines of authority.

formal communication network | Network consisting of all communications that flow along an organization's official lines of authority.

franchise | Form of business ownership in which a *franchiser* (a seller) grants a *franchisee* (a buyer) the right to use a brand name and to sell its products or services.

franchise | Form of business ownership in which a *franchiser* (a seller) grants a *franchisee* (a buyer) the right to use a brand name and to sell its products or services.

full employment | Condition under which about 95 percent of those who want to work are employed.

full employment | Condition under which about 95 percent of those who want to work are employed.

functional organization | Form of business organization that groups together people who have comparable skills and perform similar tasks.

functional organization | Form of business organization that groups together people who have comparable skills and perform similar tasks.

Gantt chart | Graphical tool for determining the status of projects.

Gantt chart | Graphical tool for determining the status of projects.

General Agreement on Tariffs and Trade (GATT) | International trade agreement that encourages free trade by regulating and reducing tariffs and provides a forum for resolving trade disputes.

General Agreement on Tariffs and Trade (GATT) | International trade agreement that encourages free trade by regulating and reducing tariffs and provides a forum for resolving trade disputes.

generally accepted accounting principles (GAAP) | Uniform set of rules for financial reporting issued by an independent agency called the Financial Accounting Standards Board (FASB).

generally accepted accounting principles (GAAP) | Uniform set of rules for financial reporting issued by an independent agency called the Financial Accounting Standards Board (FASB).

generic branding | Product with no branding information attached to it except a description of its contents.

generic branding | Product with no branding information attached to it except a description of its contents.

Geographic segmentation | Process of dividing a market according to such variables as climate, region, and population density.

Geographic segmentation | Process of dividing a market according to such variables as climate, region, and population density.

Geographical division | Organizational structure that groups people into divisions based on location.

Geographical division | Organizational structure that groups people into divisions based on location.

goods-producing sector | All businesses whose primary purpose is to produce tangible goods.

goods-producing sector | All businesses whose primary purpose is to produce tangible goods.

grievances | Union worker complaints on contract-related matters.

grievances | Union worker complaints on contract-related matters.

gross domestic product (GDP) | Measure of the market value of all goods and services produced by a nation's economy in a given year.

gross domestic product (GDP) | Measure of the market value of all goods and services produced by a nation's economy in a given year.

gross profit or gross margin | Positive difference between revenues and cost of goods sold.

gross profit or gross margin | Positive difference between revenues and cost of goods sold.

group cohesiveness | Principle that groups are most effective when members like being members.

group cohesiveness | Principle that groups are most effective when members like being members.

groupthink | Tendency to conform to group pressure in making decisions while failing to think critically or to consider outside influences.

groupthink | Tendency to conform to group pressure in making decisions while failing to think critically or to consider outside influences.

hierarchy-of-needs theory | Theory of motivation that holds that people are motivated by a hierarchical series of unmet needs.

hierarchy-of-needs theory | Theory of motivation that holds that people are motivated by a hierarchical series of unmet needs.

high-context cultures | Cultures in which personal and family connections have an effect on most interactions, including those in business.

high-context cultures | Cultures in which personal and family connections have an effect on most interactions, including those in business.

human resource management (HRM) | All actions that an organization takes to attract, develop, and retain quality employees.

human resource management (HRM) | All actions that an organization takes to attract, develop, and retain quality employees.

implied warranties | Warranty arising automatically out of a transaction.

implied warranties | Warranty arising automatically out of a transaction.

incentive programs | Program designed to financially reward employees for good performance.

incentive programs | Program designed to financially reward employees for good performance.

individual retirement account (IRA) | Personal retirement account set up by an individual to save money tax free until retirement.

individual retirement account (IRA) | Personal retirement account set up by an individual to save money tax free until retirement.

industrial market | Buyers who want a product for use in making other products.

industrial market | Buyers who want a product for use in making other products.

industrial robots | Computer-controlled machine used to perform repetitive tasks that are also hard or dangerous for human workers.

industrial robots | Computer-controlled machine used to perform repetitive tasks that are also hard or dangerous for human workers.

industry | Group of businesses that compete with one another to market products that are the same or similar.

industry | Group of businesses that compete with one another to market products that are the same or similar.

informal communication network (or grapevine) | Network that carries information whenever two or more employees get together and start talking about the company and their jobs.

informal communication network (or grapevine) | Network that carries information whenever two or more employees get together and start talking about the company and their jobs.

information | Data that have been processed or turned into some useful form.

information | Data that have been processed or turned into some useful form.

information managers | Manager with responsibility for determining the information needs of members of the organization and meeting those needs.

information managers | Manager with responsibility for determining the information needs of members of the organization and meeting those needs.

insider trading | Practice of buying or selling of securities using important information about the company before it's made public.

insider trading | Practice of buying or selling of securities using important information about the company before it's made public.

insider trading | Practice of buying or selling of securities using important information about the company before it's made public.

insider trading | Practice of buying or selling of securities using important information about the company before it's made public.

insurance companies | Nondeposit institution that collects premiums from policyholders for protection against losses and invests these funds.

insurance companies | Nondeposit institution that collects premiums from policyholders for protection against losses and invests these funds.

intentional tort | Intentional act that poses harm to another person or another person's property.

intentional tort | Intentional act that poses harm to another person or another person's property.

Interest | Cost charged to use someone else's money.

Interest | Cost charged to use someone else's money.

interest coverage ratio | Financial ratio showing a company's ability to pay interest on its debts from its operating income.

interest coverage ratio | Financial ratio showing a company's ability to pay interest on its debts from its operating income.

intermediary | Wholesaler or retailer who helps move products from their original source to the end user.

intermediary | Wholesaler or retailer who helps move products from their original source to the end user.

International Financial Reporting Standards (IFRS) | A set of worldwide accounting rules and guidelines used by companies to prepare financial statements that can be compared with those of other countries.

International Financial Reporting Standards (IFRS) | A set of worldwide accounting rules and guidelines used by companies to prepare financial statements that can be compared with those of other countries.

international franchise | Agreement in which a domestic company (franchiser) gives a foreign company (franchisee) the right to use its brand and sell its products.

international franchise | Agreement in which a domestic company (franchiser) gives a foreign company (franchisee) the right to use its brand and sell its products.

international licensing agreement | Agreement that allows a foreign company to sell a domestic company's products or use its intellectual property in exchange for royalty fees.

international licensing agreement | Agreement that allows a foreign company to sell a domestic company's products or use its intellectual property in exchange for royalty fees.

International Monetary Fund (IMF) | International organization set up to lend money to countries with troubled economies.

International Monetary Fund (IMF) | International organization set up to lend money to countries with troubled economies.

Internet service providers | Company, such as America Online, that links into the Internet infrastructure to connect paying subscribers.

Internet service providers | Company, such as America Online, that links into the Internet infrastructure to connect paying subscribers.

interpersonal skills | Skills used to get along with and motivate other people.

interpersonal skills | Skills used to get along with and motivate other people.

interruption marketing | Marketing that interrupts people to get their attention (with the hope they will listen to the ad), such as TV advertising.

interruption marketing | Marketing that interrupts people to get their attention (with the hope they will listen to the ad), such as TV advertising.

interview | Formal meeting during which the employer learns more about an applicant and the applicant learns more about the prospective employer.

interview | Formal meeting during which the employer learns more about an applicant and the applicant learns more about the prospective employer.

inventory | Goods that a business has made or bought and expects to sell in the process of normal operations.

inventory | Goods that a business has made or bought and expects to sell in the process of normal operations.

inventory control | Management of inventory to ensure that a company has enough inventory to keep operations flowing smoothly but not so much that money is being wasted in holding it.

inventory control | Management of inventory to ensure that a company has enough inventory to keep operations flowing smoothly but not so much that money is being wasted in holding it.

inventory turnover ratio | Financial ratio that shows how efficiently a company turns over its inventory.

inventory turnover ratio | Financial ratio that shows how efficiently a company turns over its inventory.

investing activities | Activity that creates cash inflows or outflows through the selling or buying of long-term assets.

investing activities | Activity that creates cash inflows or outflows through the selling or buying of long-term assets.

investment banking firm | Financial institution that specializes in issuing securities.

investment banking firm | Financial institution that specializes in issuing securities.

ISO 14000 | Set of international standards for environmental management established by the International Organization for Standardization.

ISO 14000 | Set of international standards for environmental management established by the International Organization for Standardization.

job analysis | Identification of the tasks, responsibilities, and skills of a job, as well as the knowledge and abilities needed to perform it.

job analysis | Identification of the tasks, responsibilities, and skills of a job, as well as the knowledge and abilities needed to perform it.

job description | Outline of the duties and responsibilities of a position.

job description | Outline of the duties and responsibilities of a position.

job enlargement | Job redesign strategy in which management enhances a job by adding tasks at similar skill levels.

job enlargement | Job redesign strategy in which management enhances a job by adding tasks at similar skill levels.

Job enrichment | Job redesign strategy in which management enriches a job by adding tasks that increase both responsibility and opportunity for growth.

Job enrichment | Job redesign strategy in which management enriches a job by adding tasks that increase both responsibility and opportunity for growth.

job redesign | Management strategy used to increase job satisfaction by making jobs more interesting and challenging.

job redesign | Management strategy used to increase job satisfaction by making jobs more interesting and challenging.

job rotation | Job redesign strategy that allows employees to rotate from one job to another on a systematic basis.

job rotation | Job redesign strategy that allows employees to rotate from one job to another on a systematic basis.

job sharing | Work arrangement in which two people share one full-time position.

job sharing | Work arrangement in which two people share one full-time position.

job specification | Detailed list of the qualifications needed to perform a job, including required skills, knowledge, and abilities.

job specification | Detailed list of the qualifications needed to perform a job, including required skills, knowledge, and abilities.

joint ventures | Alliances in which the partners fund a separate entity (partnership or corporation) to manage their joint operations.

joint ventures | Alliances in which the partners fund a separate entity (partnership or corporation) to manage their joint operations.

just-in-time (JIT) production | System for reducing inventories and costs by requiring suppliers to deliver materials *just in time* to go into the production process.

just-in-time (JIT) production | System for reducing inventories and costs by requiring suppliers to deliver materials *just in time* to go into the production process.

just-in-time production | System for reducing inventories and costs by requiring suppliers to deliver materials *just in time* to go into the production process.

Labeling | Information on the package of a product that identifies the product and provides details of the package contents.

Labeling | Information on the package of a product that identifies the product and provides details of the package contents.

labor union | Organized group of workers that bargains with employers to improve its members' pay, job security, and working conditions.

labor union | Organized group of workers that bargains with employers to improve its members' pay, job security, and working conditions.

law | Body of enforceable rules and principles of conduct.

law | Body of enforceable rules and principles of conduct.

layout | Arrangement in a facility of equipment, machinery, and people to make a production process as efficient as possible.

layout | Arrangement in a facility of equipment, machinery, and people to make a production process as efficient as possible.

leadership style | Particular approach used by a manager to interact with and influence others.

leadership style | Particular approach used by a manager to interact with and influence others.

leading economic indicators | Statistical data that predict the status of the economy three to twelve months in the future.

leading economic indicators | Statistical data that predict the status of the economy three to twelve months in the future.

legal monopoly | Monopoly in which one seller supplies a product or technology to which it holds a patent.

legal monopoly | Monopoly in which one seller supplies a product or technology to which it holds a patent.

legal system | Institutions and processes that enforce laws.

legal system | Institutions and processes that enforce laws.

liabilities | Debt owed by a business to an outside individual or organization.

liabilities | Debt owed by a business to an outside individual or organization.

limited liability | Legal condition under which an owner or investor can't lose more than the amount invested.

limited liability | Legal condition under which an owner or investor can't lose more than the amount invested.

limited partnership | Partnership made up of a single general partner (who runs the business and is responsible for its liabilities) and any number of limited partners.

limited partnership | Partnership made up of a single general partner (who runs the business and is responsible for its liabilities) and any number of limited partners.

limited-liability company | Corporation whose members are not personally liable for company debts and whose earnings are taxed only once, when they are paid out as dividends. It has fewer rules and restrictions than does an S-corporation.

limited-liability company | Corporation whose members are not personally liable for company debts and whose earnings are taxed only once, when they are paid out as dividends. It has fewer rules and restrictions than does an S-corporation.

lines of credit | Commitment by a bank that allows a company to borrow up to a specified amount of money as the need arises.

lines of credit | Commitment by a bank that allows a company to borrow up to a specified amount of money as the need arises.

liquidity | Speed with which an asset can be converted into cash.

liquidity | Speed with which an asset can be converted into cash.

local area network (LAN) | Network that links computers that are in close proximity.

local area network (LAN) | Network that links computers that are in close proximity.

low-context cultures | Cultures in which personal and work relationships are compartmentalized.

low-context cultures | Cultures in which personal and work relationships are compartmentalized.

M-1 | Measure of the money supply that includes only the most liquid forms of money, such as cash and checking-account funds.

M-1 | Measure of the money supply that includes only the most liquid forms of money, such as cash and checking-account funds.

make-to-order strategy | Production method in which products are made to customer specification.

make-to-order strategy | Production method in which products are made to customer specification.

management | Process of planning for, organizing, directing, and controlling a company's resources so that it can achieve its goals.

management | Process of planning for, organizing, directing, and controlling a company's resources so that it can achieve its goals.

Management | Process of planning for, organizing, directing, and controlling a company's resources so that it can achieve its goals.

Management | Process of planning for, organizing, directing, and controlling a company's resources so that it can achieve its goals.

Management accounting | Branch of accounting that provides information and analysis to decision makers inside the organization to help them operate the business.

Management accounting | Branch of accounting that provides information and analysis to decision makers inside the organization to help them operate the business.

management information system | System used to extract data from a database and compile reports that help managers make routine decisions.

management information system | System used to extract data from a database and compile reports that help managers make routine decisions.

manager | Individual in an organization who is responsible for making a group of people more effective and efficient.

manager | Individual in an organization who is responsible for making a group of people more effective and efficient.

manager-led team | Team on which a manager defines goals and methods and is solely responsible for interactions with higher-level management.

manager-led team | Team on which a manager defines goals and methods and is solely responsible for interactions with higher-level management.

manufacturer branding | Branding strategy in which a manufacturer sells one or more products under its own brand names.

manufacturer branding | Branding strategy in which a manufacturer sells one or more products under its own brand names.

manufacturing resource planning (MRP II) | System for coordinating a firm's material requirements planning activities with the activities of its other functional areas.

manufacturing resource planning (MRP II) | System for coordinating a firm's material requirements planning activities with the activities of its other functional areas.

market indexes | Measure for tracking stock prices.

market indexes | Measure for tracking stock prices.

market segments | Group of potential customers with common characteristics that influence their buying decisions.

market segments | Group of potential customers with common characteristics that influence their buying decisions.

market share | Company's portion of the market that it has targeted.

market share | Company's portion of the market that it has targeted.

Marketing | Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.

Marketing | Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.

Marketing | Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.

Marketing | Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.

marketing concept | Basic philosophy of satisfying customer needs while meeting organizational goals.

marketing concept | Basic philosophy of satisfying customer needs while meeting organizational goals.

marketing mix | Combination of product, price, place, and promotion (often called the four Ps) used to market products.

marketing mix | Combination of product, price, place, and promotion (often called the four Ps) used to market products.

marketing research | Process of collecting and analyzing data that's relevant to a specific marketing situation.

marketing research | Process of collecting and analyzing data that's relevant to a specific marketing situation.

marketing strategy | Plan for selecting a target market and creating, pricing, promoting, and distributing products that satisfy customers.

marketing strategy | Plan for selecting a target market and creating, pricing, promoting, and distributing products that satisfy customers.

mass customization | Production method in which fairly high volumes of customized products are made at fairly low prices.

mass customization | Production method in which fairly high volumes of customized products are made at fairly low prices.

mass production (or make-to-stock strategy) | Production method in which high volumes of products are made at low cost and held in inventory in anticipation of future demand.

mass production (or make-to-stock strategy) | Production method in which high volumes of products are made at low cost and held in inventory in anticipation of future demand.

master production schedule (MPS) | Timetable that specifies which and how many products will be produced and when.

master production schedule (MPS) | Timetable that specifies which and how many products will be produced and when.

material requirements planning (MRP) | Technique of using a computerized program to calculate the quantity of materials needed for production and to reschedule inventory ordering.

material requirements planning (MRP) | Technique of using a computerized program to calculate the quantity of materials needed for production and to reschedule inventory ordering.

materials handling | Process of physically moving or carrying goods during production, warehousing, and distribution.

materials handling | Process of physically moving or carrying goods during production, warehousing, and distribution.

materials management | All decisions pertaining to the purchase of inputs, the inventory of components and finished products, and the scheduling of production processes.

materials management | All decisions pertaining to the purchase of inputs, the inventory of components and finished products, and the scheduling of production processes.

matrix structure | Structure in which employees from various functional areas form teams to combine their skills in working on a specific project.

matrix structure | Structure in which employees from various functional areas form teams to combine their skills in working on a specific project.

middle managers | Those in the middle of the management hierarchy who report to top management and oversee the activities of first-line managers.

middle managers | Those in the middle of the management hierarchy who report to top management and oversee the activities of first-line managers.

misdemeanor | Crime that's not "inherently evil" but that's nevertheless prohibited by society.

misdemeanor | Crime that's not "inherently evil" but that's nevertheless prohibited by society.

mission statement | Statement describing an organization's purpose or *mission*—its reason for existence—and telling stakeholders what the organization is committed to doing.

mission statement | Statement describing an organization's purpose or *mission*—its reason for existence—and telling stakeholders what the organization is committed to doing.

Money | Anything commonly accepted as a medium of exchange, measure of value, and store of value.

Money | Anything commonly accepted as a medium of exchange, measure of value, and store of value.

money market funds | Fund invested in safe, highly liquid securities.

money market funds | Fund invested in safe, highly liquid securities.

money market mutual funds | Accounts that pay interest to investors who pool funds to make short-term loans to businesses and the government.

money market mutual funds | Accounts that pay interest to investors who pool funds to make short-term loans to businesses and the government.

money multiplier | The amount by which an initial bank deposit will expand the money supply.

money multiplier | The amount by which an initial bank deposit will expand the money supply.

monopolistic competition | Market in which many sellers supply differentiated products.

monopolistic competition | Market in which many sellers supply differentiated products.

monopoly | Market in which there is only one seller supplying products at regulated prices.

monopoly | Market in which there is only one seller supplying products at regulated prices.

Motivation | Internally generated drive to achieve a goal or follow a particular course of action.

Motivation | Internally generated drive to achieve a goal or follow a particular course of action.

multinational corporation (MNC) | Large corporation that operates in many countries.

multinational corporation (MNC) | Large corporation that operates in many countries.

NASDAQ | Best-known over-the-counter, electronic exchange system.

NASDAQ | Best-known over-the-counter, electronic exchange system.

national debt | Total amount of money owed by the federal government.

national debt | Total amount of money owed by the federal government.

Natural monopolies | Monopoly in which, because of the industry's importance to society, one seller is permitted to supply products without competition.

Natural monopolies | Monopoly in which, because of the industry's importance to society, one seller is permitted to supply products without competition.

negligence tort | Tort resulting from carelessness.

negligence tort | Tort resulting from carelessness.

net income | Positive difference between gross profit and total expenses.

net income | Positive difference between gross profit and total expenses.

net worth | The difference between an individual's assets and liabilities.

net worth | The difference between an individual's assets and liabilities.

net worth statement | A personal balance sheet that lists the value of the things you own, the amounts owed to others, and the difference, called "net worth."

net worth statement | A personal balance sheet that lists the value of the things you own, the amounts owed to others, and the difference, called "net worth."

niche | Narrowly defined group of potential customers with a fairly specific set of needs.

niche | Narrowly defined group of potential customers with a fairly specific set of needs.

nonverbal communication | "Nonword" messages communicated through facial expressions, posture, gestures, and tone of voice.

nonverbal communication | "Nonword" messages communicated through facial expressions, posture, gestures, and tone of voice.

North American Free Trade Association (NAFTA) | Agreement among the governments of the United States, Canada, and Mexico to open their borders to unrestricted trade.

North American Free Trade Association (NAFTA) | Agreement among the governments of the United States, Canada, and Mexico to open their borders to unrestricted trade.

not-for-profit (or nonprofit) organizations | Organization that has a purpose other than returning profits to owners.

not-for-profit (or nonprofit) organizations | Organization that has a purpose other than returning profits to owners.

not-for-profit corporation | An organization formed to serve some public purpose rather than for financial gain.

not-for-profit corporation | An organization formed to serve some public purpose rather than for financial gain.

Objectives | Intermediate-term performance targets that direct the activities of an organization toward the attainment of a goal.

Objectives | Intermediate-term performance targets that direct the activities of an organization toward the attainment of a goal.

Occupational Health and Safety Administration (OSHA) | Federal administrative agency empowered to set workplace safety and health standards and to ensure that employers take appropriate steps to meet them.

Occupational Health and Safety Administration (OSHA) | Federal administrative agency empowered to set workplace safety and health standards and to ensure that employers take appropriate steps to meet them.

odd-even pricing | Practice of pricing products a few cents (or dollars) under an even number.

odd-even pricing | Practice of pricing products a few cents (or dollars) under an even number.

offshoring | Setting up facilities in a foreign country that replace U.S. manufacturing facilities to produce goods that will be sent back to the United States for sale.

offshoring | Setting up facilities in a foreign country that replace U.S. manufacturing facilities to produce goods that will be sent back to the United States for sale.

Oligopoly | Market in which a few sellers supply a large portion of all the products sold in the marketplace.

Oligopoly | Market in which a few sellers supply a large portion of all the products sold in the marketplace.

on-the-job training | Employee training (often informal) that occurs while the employee is on the job.

on-the-job training | Employee training (often informal) that occurs while the employee is on the job.

open market operations | The sale and purchase of U.S. government bonds by the Fed in the open market.

open market operations | The sale and purchase of U.S. government bonds by the Fed in the open market.

operating activities | Activity that creates cash inflows or outflows through day-to-day operations.

operating activities | Activity that creates cash inflows or outflows through day-to-day operations.

operational plans | Detailed action steps to be taken by individuals or groups to implement tactical plans.

operational plans | Detailed action steps to be taken by individuals or groups to implement tactical plans.

operations management (OM) | Management of the process that transforms resources into products.

operations management (OM) | Management of the process that transforms resources into products.

operations manager | Person who designs and oversees the process that converts resources into goods or services.

operations manager | Person who designs and oversees the process that converts resources into goods or services.

Operations support systems | Information system used by lower-level managers to assist them in running day-to-day operations and making routine decisions.

Operations support systems | Information system used by lower-level managers to assist them in running day-to-day operations and making routine decisions.

organization chart | Diagram representing the interrelationships of positions within an organization.

organization chart | Diagram representing the interrelationships of positions within an organization.

organizing | Management process of allocating resources to achieve a company's plans.

organizing | Management process of allocating resources to achieve a company's plans.

orientation | Activities involved in introducing new employees to the organization and their jobs.

orientation | Activities involved in introducing new employees to the organization and their jobs.

outsourcing | Practice of using outside vendors to manufacture all or part of a company's actual products.

outsourcing | Practice of using outside vendors to manufacture all or part of a company's actual products.

outsourcing | Practice of using outside vendors to manufacture all or part of a company's actual products.

owner's equity | Amount which is invested in a business by its owners and which owners can claim from its assets.

owner's equity | Amount which is invested in a business by its owners and which owners can claim from its assets.

partnership (or general partnership) | Business owned jointly by two or more people.

partnership (or general partnership) | Business owned jointly by two or more people.

patent | Grant of the exclusive right to produce or sell a product, process, or invention.

patent | Grant of the exclusive right to produce or sell a product, process, or invention.

penetration pricing | Pricing strategy in which the seller charges a low price on a new product to discourage competition and gain market share.

penetration pricing | Pricing strategy in which the seller charges a low price on a new product to discourage competition and gain market share.

pension funds | Fund set up to collect contributions from participating companies for the purpose of providing its members with retirement income.

pension funds | Fund set up to collect contributions from participating companies for the purpose of providing its members with retirement income.

Perfect competition | Market in which many consumers buy standardized products from numerous small businesses.

Perfect competition | Market in which many consumers buy standardized products from numerous small businesses.

performance appraisals | Formal process in which a manager evaluates an employee's work performance.

performance appraisals | Formal process in which a manager evaluates an employee's work performance.

personal finance | The application of financial principles to the monetary decisions of an individual or a family.

personal finance | The application of financial principles to the monetary decisions of an individual or a family.

Personal selling | One-on-one communication with customers or potential customers.

Personal selling | One-on-one communication with customers or potential customers.

PERT charts | Tool for diagramming the activities required to produce a product, specifying the time required to perform each activity in the process, and organizing activities in the most efficient sequence.

PERT charts | Tool for diagramming the activities required to produce a product, specifying the time required to perform each activity in the process, and organizing activities in the most efficient sequence.

physical distribution | Activities needed to get a product from where it was manufactured to the customer.

physical distribution | Activities needed to get a product from where it was manufactured to the customer.

picketing | Union tactic of parading with signs outside a factory or other facility to publicize a strike.

picketing | Union tactic of parading with signs outside a factory or other facility to publicize a strike.

planning | Process of setting goals and determining the best way to achieve them.

planning | Process of setting goals and determining the best way to achieve them.

platform as a service (PaaS) | Those offering the platform as a service category of cloud computing provide services that enable users to develop customized web applications.

platform as a service (PaaS) | Those offering the platform as a service category of cloud computing provide services that enable users to develop customized web applications.

precedent | Rule of case law that must be used by lower courts in deciding future cases.

precedent | Rule of case law that must be used by lower courts in deciding future cases.

Preferred stock | Stock that pays owners a fixed dividend annually.

Preferred stock | Stock that pays owners a fixed dividend annually.

premises liability | The duty of innkeepers to take reasonable care in preventing customers and third parties from being injured on their property.

prestige-pricing | Practice of setting a price artificially high to foster the impression that it is a product of high quality.

prestige-pricing | Practice of setting a price artificially high to foster the impression that it is a product of high quality.

primary data | Newly collected marketing information that addresses specific questions about the target market.

primary data | Newly collected marketing information that addresses specific questions about the target market.

primary market | Market that deals in the sale of newly issued securities.

primary market | Market that deals in the sale of newly issued securities.

prime rate | Rate that banks charge their best customers.

prime rate | Rate that banks charge their best customers.

private accountants | Accountant who works for a private organization or government agency.

private accountants | Accountant who works for a private organization or government agency.

private branding | Product made by a manufacturer and sold to a retailer who in turn resells it under its own name.

private branding | Product made by a manufacturer and sold to a retailer who in turn resells it under its own name.

privatization | Process of converting government-owned businesses to private ownership.

privatization | Process of converting government-owned businesses to private ownership.

Process control | Application of technology to monitor and control physical processes.

Process control | Application of technology to monitor and control physical processes.

process division | Organizational structure that groups people into operating units based on various stages in the production process.

process division | Organizational structure that groups people into operating units based on various stages in the production process.

process layout | Layout that groups together workers or departments that perform similar tasks.

process layout | Layout that groups together workers or departments that perform similar tasks.

product | Something that can be marketed to customers because it provides a benefit and satisfies a need.

product | Something that can be marketed to customers because it provides a benefit and satisfies a need.

product concept | Description of what a new product will look like and how it will work.

product concept | Description of what a new product will look like and how it will work.

product development process | Series of activities by which a product idea is transformed into a final product.

product development process | Series of activities by which a product idea is transformed into a final product.

Product division | Organizational structure made up of divisions based on product lines.

Product division | Organizational structure made up of divisions based on product lines.

product layout | Layout in which products are produced by people, equipment, or departments arranged in an assembly line.

product layout | Layout in which products are produced by people, equipment, or departments arranged in an assembly line.

product liability | Claim of injury suffered because of a defective product.

product liability | Claim of injury suffered because of a defective product.

product life cycle | Four stages that a product goes through over its life: introduction, growth, maturity, and decline.

product life cycle | Four stages that a product goes through over its life: introduction, growth, maturity, and decline.

profit | Difference between the revenue that a company brings in from selling goods and services and the costs of generating this revenue.

profit | Difference between the revenue that a company brings in from selling goods and services and the costs of generating this revenue.

profit margin | Amount that a company earns on each unit sold.

profit margin | Amount that a company earns on each unit sold.

profit-sharing plan | Incentive program that uses a predetermined formula to distribute a share of company profits to eligible employees.

profit-sharing plan | Incentive program that uses a predetermined formula to distribute a share of company profits to eligible employees.

project team | Individuals from different functional areas assigned to work together throughout the product development process.

project team | Individuals from different functional areas assigned to work together throughout the product development process.

promotion mix | Various ways to communicate with customers, including advertising, personal selling, sales promotion, and publicity.

promotion mix | Various ways to communicate with customers, including advertising, personal selling, sales promotion, and publicity.

prospectus | Written offer to sell securities that provides useful information to prospective buyers.

prospectus | Written offer to sell securities that provides useful information to prospective buyers.

protectionism | Use of trade controls to reduce foreign competition in order to protect domestic industries.

protectionism | Use of trade controls to reduce foreign competition in order to protect domestic industries.

prototype | Physical model of a new product.

prototype | Physical model of a new product.

Psychographic segmentation | Process of classifying consumers on the basis of individual lifestyles as reflected in people's interests, activities, attitudes, and values.

Psychographic segmentation | Process of classifying consumers on the basis of individual lifestyles as reflected in people's interests, activities, attitudes, and values.

public corporations | Corporation whose stock is available to the general public.

public corporations | Corporation whose stock is available to the general public.

public law | Body of law dealing with the relationship of government to private individuals and other private entities.

public law | Body of law dealing with the relationship of government to private individuals and other private entities.

public relations | Communication activities undertaken by companies to garner favorable publicity for themselves and their products.

public relations | Communication activities undertaken by companies to garner favorable publicity for themselves and their products.

publicity | Form of promotion that focuses on getting a company or product mentioned in a newspaper, on TV, or in some other news media.

publicity | Form of promotion that focuses on getting a company or product mentioned in a newspaper, on TV, or in some other news media.

punitive damages | Monetary awards to tort victims intended to deter similar injurious conduct in the future.

punitive damages | Monetary awards to tort victims intended to deter similar injurious conduct in the future.

purchasing | Process of acquiring materials and services to be used in production.

purchasing | Process of acquiring materials and services to be used in production.

quality | Ability of a product to satisfy customer needs.

quality | Ability of a product to satisfy customer needs.

quality circles | Employees who perform similar jobs and work as teams to identify quality, efficiency, and other work-related problems; to propose solutions; and to work with management in implementing their recommendations.

quality circles | Employees who perform similar jobs and work as teams to identify quality, efficiency, and other work-related problems; to propose solutions; and to work with management in implementing their recommendations.

quota | Government-imposed restrictions on the quantity of a good that can be imported over a period of time.

quota | Government-imposed restrictions on the quantity of a good that can be imported over a period of time.

ramp-up stage | Stage in the product development process during which employees are trained in necessary production processes and new products are tested.

ramp-up stage | Stage in the product development process during which employees are trained in necessary production processes and new products are tested.

ratio analysis | Technique for financial analysis that shows the relationship between two numbers.

ratio analysis | Technique for financial analysis that shows the relationship between two numbers.

recession | Economic slowdown measured by a decline in gross domestic productivity.

recession | Economic slowdown measured by a decline in gross domestic productivity.

Recruiting | Process of identifying suitable candidates and encouraging them to apply for openings in the organization.

Recruiting | Process of identifying suitable candidates and encouraging them to apply for openings in the organization.

relationship-building role | Member role that helps a team maintain or improve group cohesiveness.

relationship-building role | Member role that helps a team maintain or improve group cohesiveness.

reporting relationships | Patterns of formal communication among members of an organization.

reporting relationships | Patterns of formal communication among members of an organization.

Resources | Inputs used to produce outputs.

Resources | Inputs used to produce outputs.

restructuring | Process of altering an existing organizational structure to become more competitive under changing conditions.

restructuring | Process of altering an existing organizational structure to become more competitive under changing conditions.

Retailers | Intermediaries who buy goods from producers and sell them to consumers.

Retailers | Intermediaries who buy goods from producers and sell them to consumers.

rule of law | Principle by which government legitimately exercises its authority only in accordance with publicly declared laws that are adopted and enforced according to established procedure.

rule of law | Principle by which government legitimately exercises its authority only in accordance with publicly declared laws that are adopted and enforced according to established procedure.

salary | Compensation paid for fulfilling the responsibilities of a position regardless of the number of hours required to do it.

salary | Compensation paid for fulfilling the responsibilities of a position regardless of the number of hours required to do it.

sales promotion | Sales approach in which a company provides an incentive for potential customers to buy something.

sales promotion | Sales approach in which a company provides an incentive for potential customers to buy something.

Sarbanes-Oxley Act (SOX) | A federal law enacted to encourage ethical corporate behavior and discourage fraud and other wrongdoing.

Sarbanes-Oxley Act (SOX) | A federal law enacted to encourage ethical corporate behavior and discourage fraud and other wrongdoing.

Savings banks | Financial institution originally set up to provide mortgages and encourage saving, which now offers services similar to those of commercial banks.

Savings banks | Financial institution originally set up to provide mortgages and encourage saving, which now offers services similar to those of commercial banks.

search engine | Software program that scans Web pages for specified keywords and provides a list of documents containing them.

search engine | Software program that scans Web pages for specified keywords and provides a list of documents containing them.

secondary data | Information used in marketing decisions that has already been collected for other purposes.

secondary data | Information used in marketing decisions that has already been collected for other purposes.

Securities and Exchange Commission (SEC) | Government agency that enforces securities laws.

Securities and Exchange Commission (SEC) | Government agency that enforces securities laws.

selection | Process of gathering information on candidates, evaluating their qualifications, and choosing the right one.

selection | Process of gathering information on candidates, evaluating their qualifications, and choosing the right one.

Self-managing teams | Team on which employees control the activities needed to meet overall goals.

Self-managing teams | Team on which employees control the activities needed to meet overall goals.

Service Corps of Retired Executives (SCORE) | SBA program in which a businessperson needing advice is matched with a member of a team of retired executives working as volunteers.

Service Corps of Retired Executives (SCORE) | SBA program in which a businessperson needing advice is matched with a member of a team of retired executives working as volunteers.

service-producing sector | All businesses whose primary purpose is to provide a service rather than make tangible goods.

service-producing sector | All businesses whose primary purpose is to provide a service rather than make tangible goods.

skimming pricing | Pricing strategy in which a seller generates early profits by starting off charging the highest price that customers will pay.

skimming pricing | Pricing strategy in which a seller generates early profits by starting off charging the highest price that customers will pay.

small business | According to the SBA, a business that is independently operated, exerts little influence in its industry, and employs fewer than five hundred people.

small business | According to the SBA, a business that is independently operated, exerts little influence in its industry, and employs fewer than five hundred people.

Small Business Administration (SBA) | Government agency that helps prospective owners set up small businesses, obtain financing, and manage ongoing operations.

Small Business Administration (SBA) | Government agency that helps prospective owners set up small businesses, obtain financing, and manage ongoing operations.

Small Business Development Center (SBDC) | SBA program in which centers housed at colleges and other locations provide free training and technical information to current and prospective small business owners.

Small Business Development Center (SBDC) | SBA program in which centers housed at colleges and other locations provide free training and technical information to current and prospective small business owners.

social media marketing | The practice of including social media as part of a company's marketing program.

social media marketing | The practice of including social media as part of a company's marketing program.

socialism | Economic system falling between communism and capitalism in terms of government control over allocation and distribution.

socialism | Economic system falling between communism and capitalism in terms of government control over allocation and distribution.

sole proprietorship | Business owned by only one person.

sole proprietorship | Business owned by only one person.

span of control | Number of people reporting to a particular manager.

span of control | Number of people reporting to a particular manager.

specialization | Process of organizing activities into clusters of related tasks that can be handled by specific individuals or groups.

specialization | Process of organizing activities into clusters of related tasks that can be handled by specific individuals or groups.

stakeholders | Parties who are interested in the activities of a business because they're affected by them.

stakeholders | Parties who are interested in the activities of a business because they're affected by them.

Standard & Poor's Composite Index (S&P 500) | Market index of the stocks of five hundred large U.S. companies.

Standard & Poor's Composite Index (S&P 500) | Market index of the stocks of five hundred large U.S. companies.

statement of cash flows | Financial statement reporting on cash inflows and outflows resulting from operating, investing, and financing activities.

statement of cash flows | Financial statement reporting on cash inflows and outflows resulting from operating, investing, and financing activities.

statement of owner's equity | A financial statement that details changes in owner's equity for a specified period of time.

statement of owner's equity | A financial statement that details changes in owner's equity for a specified period of time.

statistical process control | Technique for monitoring production quality by testing sample outputs to ensure that they meet specifications.

statistical process control | Technique for monitoring production quality by testing sample outputs to ensure that they meet specifications.

stock-option plans | Incentive program that allows eligible employees to buy a specific number of shares of company stock at a set price on a specified date.

stock-option plans | Incentive program that allows eligible employees to buy a specific number of shares of company stock at a set price on a specified date.

stockholders' equity | Amount invested in a corporation by its shareholders.

stockholders' equity | Amount invested in a corporation by its shareholders.

strategic alliance | Agreement between two companies (or a company and a nation) to pool resources in order to achieve business goals that benefit both partners.

strategic alliance | Agreement between two companies (or a company and a nation) to pool resources in order to achieve business goals that benefit both partners.

strategic human resource planning | Process of developing a plan for satisfying an organization's human resource needs.

strategic human resource planning | Process of developing a plan for satisfying an organization's human resource needs.

strategic planning | Process of establishing an overall plan or course of action for an organization.

strategic planning | Process of establishing an overall plan or course of action for an organization.

strict liability torts | Tort resulting from actions that are inherently dangerous and for which a party may be liable no matter how carefully he or she performs them.

strict liability torts | Tort resulting from actions that are inherently dangerous and for which a party may be liable no matter how carefully he or she performs them.

strike | Union tactic by which workers walk away from their jobs and refuse to return until a labor-management dispute has been resolved.

strike | Union tactic by which workers walk away from their jobs and refuse to return until a labor-management dispute has been resolved.

strikebreakers | Nonunion workers who are willing to cross picket lines to replace strikers.

strikebreakers | Nonunion workers who are willing to cross picket lines to replace strikers.

subprime mortgage loan | Mortgage loans made to borrowers who don't qualify for market-set interest rates because of one or more risk factors.

subprime mortgage loan | Mortgage loans made to borrowers who don't qualify for market-set interest rates because of one or more risk factors.

subsidies | Government payments given to certain industries to help offset some of their costs of production.

subsidies | Government payments given to certain industries to help offset some of their costs of production.

Supply | Quantity of a product that sellers are willing to sell at various prices.

Supply | Quantity of a product that sellers are willing to sell at various prices.

supply chain management (SCM) | Process of integrating all the activities in the supply chain.

supply chain management (SCM) | Process of integrating all the activities in the supply chain.

supply curve | Graph showing the quantity of a product that will be offered for sale at certain prices.

supply curve | Graph showing the quantity of a product that will be offered for sale at certain prices.

sustainability | The principle of providing products today that don't compromise the ability of future generations to meet their needs.

sustainability | The principle of providing products today that don't compromise the ability of future generations to meet their needs.

SWOT analysis | Approach used to assess a company's fit with its environment by analyzing its strengths, weaknesses, opportunities, and threats.

SWOT analysis | Approach used to assess a company's fit with its environment by analyzing its strengths, weaknesses, opportunities, and threats.

tactical plans | Short-term plans that specify the activities and resources needed to implement a company's strategic plan.

tactical plans | Short-term plans that specify the activities and resources needed to implement a company's strategic plan.

target costing | Pricing strategy that determines how much to invest in a product by figuring out how much customers will pay and subtracting an amount for profit.

target costing | Pricing strategy that determines how much to invest in a product by figuring out how much customers will pay and subtracting an amount for profit.

target market | Specific group of customers who should be interested in your product, have access to it, and have the means to buy it.

target market | Specific group of customers who should be interested in your product, have access to it, and have the means to buy it.

Tariffs | Government taxes on imports that raise the price of foreign goods and make them less competitive with domestic goods.

Tariffs | Government taxes on imports that raise the price of foreign goods and make them less competitive with domestic goods.

Task-facilitating roles | Member role that helps a team accomplish its goals.

Task-facilitating roles | Member role that helps a team accomplish its goals.

team | Group of people with complementary skills who work together to achieve a specific goal.

team | Group of people with complementary skills who work together to achieve a specific goal.

technical skills | Skills needed to perform specific tasks.

technical skills | Skills needed to perform specific tasks.

Telecommuting | Work arrangement in which the employee regularly works from home.

Telecommuting | Work arrangement in which the employee regularly works from home.

time value of money | The principle whereby a dollar received in the present is worth more than a dollar received in the future.

time value of money | The principle whereby a dollar received in the present is worth more than a dollar received in the future.

time-management skills | Skills used to manage time effectively.

time-management skills | Skills used to manage time effectively.

Top managers | Those at the top of the management hierarchy who are responsible for the health and performance of the organization.

Top managers | Those at the top of the management hierarchy who are responsible for the health and performance of the organization.

tort | Civil wrong; injury done to someone's person or property.

tort | Civil wrong; injury done to someone's person or property.

tort reform | A movement to stem the swelling tide of personal-injury litigation in the United States.

Total quality management (TQM) | All the steps taken by a company to ensure that its products satisfy customer needs.

Total quality management (TQM) | All the steps taken by a company to ensure that its products satisfy customer needs.

trade credit | Credit given to a company by its suppliers.

trade credit | Credit given to a company by its suppliers.

trade deficit | Condition whereby a country buys more products than it sells, resulting in an unfavorable trade balance.

trade deficit | Condition whereby a country buys more products than it sells, resulting in an unfavorable trade balance.

trademark | Word, symbol, or other mark used to identify and legally protect a product from being copied.

trademark | Word, symbol, or other mark used to identify and legally protect a product from being copied.

trading blocs | Groups of countries that have joined together to allow goods and services to flow without restrictions across their mutual borders.

trading blocs | Groups of countries that have joined together to allow goods and services to flow without restrictions across their mutual borders.

transactions | Financial and nonfinancial events that affect a business.

transactions | Financial and nonfinancial events that affect a business.

transformational leaders | Managers who mentor and develop subordinates and stimulate them to look beyond personal interests to those of the group.

transformational leaders | Managers who mentor and develop subordinates and stimulate them to look beyond personal interests to those of the group.

turnover | Permanent separation of an employee from a company.

turnover | Permanent separation of an employee from a company.

two-factor theory | Theory that holds that motivation involves both motivation factors (which contribute to job satisfaction) and hygiene factors (which help to prevent job dissatisfaction).

two-factor theory | Theory that holds that motivation involves both motivation factors (which contribute to job satisfaction) and hygiene factors (which help to prevent job dissatisfaction).

unemployment rate | Percentage of the total labor force that's currently unemployed and actively seeking work.

unemployment rate | Percentage of the total labor force that's currently unemployed and actively seeking work.

Uniform Commercial Code (UCC) | U.S. system of statutes designed to make commercial transactions consistent in all fifty states.

Uniform Commercial Code (UCC) | U.S. system of statutes designed to make commercial transactions consistent in all fifty states.

unlimited liability | Legal condition under which an owner or investor is personally liable for all debts of a business.

unlimited liability | Legal condition under which an owner or investor is personally liable for all debts of a business.

unsecured loan | Loan given by a bank that doesn't require the borrower to put up collateral.

unsecured loan | Loan given by a bank that doesn't require the borrower to put up collateral.

value chain | Entire range of activities involved in delivering value to customers.

value chain | Entire range of activities involved in delivering value to customers.

variable costs | Costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis.

variable costs | Costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis.

variable costs | Costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis.

variable costs | Costs that vary, in total, as the quantity of goods sold changes but stay constant on a per-unit basis.

variance | Difference between the actual amount and the budgeted amount.

variance | Difference between the actual amount and the budgeted amount.

Venture capitalists | Individual who pools funds from private and institutional sources and invests them in businesses with strong growth potential.

Venture capitalists | Individual who pools funds from private and institutional sources and invests them in businesses with strong growth potential.

vertical percentage analysis | Analysis of an income statement treating the relationship of each item as a percentage of a base (usually sales).

vertical percentage analysis | Analysis of an income statement treating the relationship of each item as a percentage of a base (usually sales).

virtual company | Company without a significant physical presence that relies on third parties to produce, warehouse, price, and deliver the products it sells over the Internet.

virtual company | Company without a significant physical presence that relies on third parties to produce, warehouse, price, and deliver the products it sells over the Internet.

virtual teams | Teams whose geographically dispersed members interact electronically in the process of pursuing a common goal.

virtual teams | Teams whose geographically dispersed members interact electronically in the process of pursuing a common goal.

whistle-blower | Individual who exposes illegal or unethical behavior in an organization.

whistle-blower | Individual who exposes illegal or unethical behavior in an organization.

wholesalers | Intermediaries who buy goods from suppliers and sell them to businesses that will either resell or use them.

wholesalers | Intermediaries who buy goods from suppliers and sell them to businesses that will either resell or use them.

wide area network (WAN) | Network that links computers that are spread over a relatively large geographical area.

wide area network (WAN) | Network that links computers that are spread over a relatively large geographical area.

World Bank | International financial institution that provides economic assistance to poor and developing countries.

World Bank | International financial institution that provides economic assistance to poor and developing countries.

World Trade Organization (WTO) | International organization that monitors trade policies and whose members work together to enforce rules of trade and resolve trade disputes.

World Trade Organization (WTO) | International organization that monitors trade policies and whose members work together to enforce rules of trade and resolve trade disputes.

World Wide Web | Subsystem of computers on the Internet that communicate with each other using a special language called HTTP.

World Wide Web | Subsystem of computers on the Internet that communicate with each other using a special language called HTTP.

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