

understanding **BUSINESS**

Tenth Edition

Nickels

McHugh

McHugh

part 1

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NAME THAT

company

This microlending organization provides small loans to entrepreneurs too poor to qualify for traditional loans. The person who started the organization has started 30 of what he calls social businesses that do not have profit as their goal. Name that organization and its founder. (Find the answers in the chapter.)

LEARNING goal 1

Describe the relationship between profit and risk, and show how businesses and nonprofit organizations can raise the standard of living for all.

business

Any activity that seeks to provide goods and services to others while operating at a profit.

goods

Tangible products such as computers, food, clothing, cars, and appliances.

services

Intangible products (i.e., products that can't be held in your hand) such as education, health care, insurance, recreation, and travel and tourism.

entrepreneur

A person who risks time and money to start and manage a business.

revenue

The total amount of money a business takes in during a given period by selling goods and services.

profit

The amount of money a business earns above and beyond what it spends for salaries and other expenses.

loss

When a business's expenses are more than its revenues.

ENTREPRENEURSHIP AND WEALTH BUILDING

One thing you can learn from the chapter-opening Profile is that success in business is based on constantly adapting to the market. A **business** is any activity that seeks to provide goods and services to others while operating at a profit. To earn that profit, you provide desired goods, jobs, and services to people in the area. **Goods** are *tangible* products such as computers, food, clothing, cars, and appliances. **Services** are *intangible* products (i.e., products that can't be held in your hand) such as education, health care, insurance, recreation, and travel and tourism. Once you have developed the right goods and services, based on consumer wants and needs, you need to reach those consumers using whatever media they prefer, including blogs, tweets, Facebook, TV advertising, and more.¹

Although you don't need to have wealth as a primary goal, one result of successfully filling a market need is that you can make money for yourself, sometimes a great deal, by giving customers what they want. Sam Walton of Walmart began by opening one store in Arkansas and, over time, became one of the richest people in the United States.² There are over 11 million millionaires in the world.³ Maybe you will be one of them some day if you start your own business. An **entrepreneur** is a person who risks time and money to start and manage a business.

Revenues, Profits, and Losses

Revenue is the total amount of money a business takes in during a given period by selling goods and services. **Profit** is the amount of money a business earns above and beyond what it spends for salaries and other expenses needed to run the operation. A **loss** occurs when a business's expenses are more than its revenues. If a business loses money over time, it will likely have to close, putting its employees out of work. About 80,000 businesses in the United States close each year; even more close during a slowdown like the United States experienced starting in 2008.⁴

As noted above, the business environment is constantly changing. What seems like a great opportunity one day—for example, online grocery shopping or SUVs—may become a huge failure when the economy changes. Starting a business may thus come with huge risks.⁵ But huge risks often result in huge profits. We'll explore that concept next.

Matching Risk with Profit

Risk is the chance an entrepreneur takes of losing time and money on a business that may not prove profitable. Profit, remember, is the amount of money a business earns *above and beyond* what it pays out for salaries and other expenses. For example, if you were to start a business selling hot dogs from a cart in the summer, you would have to pay for the cart rental. You would also have to pay for the hot dogs and other materials and for someone to run the cart while you were away. After you paid your employee and yourself, paid for the food and materials you used, paid the rent on the cart, and paid your taxes, any money left over would be profit.

Keep in mind that profit is over and above the money you pay yourself in salary. You could use any profit to rent or buy a second cart and hire other employees. After a few summers, you might have a dozen carts employing dozens of workers.

Not all enterprises make the same amount of profit. Those that take the most risk may make the most profit. There is high risk, for example, in making a new kind of automobile.⁶ It's also risky to open a business in an inner city, because insurance and rent are usually higher than in suburban areas, but reduced competition makes substantial profit possible. Irish entrepreneur Denis O'Brien, of Digicel, makes billions of dollars selling cell phones in the poorest, most violent countries in the world. Big risk, big profits.

Standard of Living and Quality of Life

Entrepreneurs such as Sam Walton (Walmart) and Bill Gates (Microsoft) not only became wealthy themselves; they also provided employment for many other people. Walmart is currently the nation's largest private employer.

Businesses and their employees pay taxes that the federal government and local communities use to build hospitals, schools, libraries, playgrounds, roads, and other public facilities. Taxes also help to keep the environment clean, support people in need, and provide police and fire protection. Thus, the wealth businesses generate and the taxes they pay help everyone in their communities. A nation's businesses are part of an economic system that contributes to the standard of living and quality of life for everyone in the country (and, potentially, the world). How has the recent economic slowdown affected the standard of living and quality of life in your part of the world?

The term **standard of living** refers to the amount of goods and services people can buy with the money they have. For example, the United States has one of the highest standards of living in the world, even though workers in some other countries, such as Germany and Japan, may on average make more money per hour. How can that be? Prices for goods and services in Germany and Japan are higher than in the United States, so a person in those countries can buy less than what a person in the United States can buy with the same amount of money. For example, a bottle of beer may cost \$7 in Japan and \$3 in the United States.

risk

The chance an entrepreneur takes of losing time and money on a business that may not prove profitable.

standard of living

The amount of goods and services people can buy with the money they have.

Mary Kate and Ashley Olsen are now the head designers of their company Dualstar which has three clothing lines ranging from the high-end to the more affordable. Today the business is worth over \$1 billion. What risks and rewards did the twins face when they started their business?



Often, goods cost more in one country than another because of higher taxes and stricter government regulations. Finding the right level of taxes and regulation is important in making a country or city prosperous. We'll explore that issue more deeply in Chapter 2. At this point, it is enough to understand that the United States enjoys a high standard of living largely because of the wealth created by its businesses.

The term **quality of life** refers to the general well-being of a society in terms of its political freedom, natural environment, education, health care, safety, amount of leisure, and rewards that add to the satisfaction and joy that other goods and services provide. Maintaining a high quality of life requires the combined efforts of businesses, nonprofit organizations, and government agencies. The more money businesses create, the more is potentially available to improve the quality of life for everyone. It's important to be careful, however. Working to build a higher standard of living may lower the quality of life if it means less time with family or more stress.⁷

quality of life

The general well-being of a society in terms of its political freedom, natural environment, education, health care, safety, amount of leisure, and rewards that add to the satisfaction and joy that other goods and services provide.

stakeholders

All the people who stand to gain or lose by the policies and activities of a business and whose concerns the business needs to address.

Responding to the Various Business Stakeholders

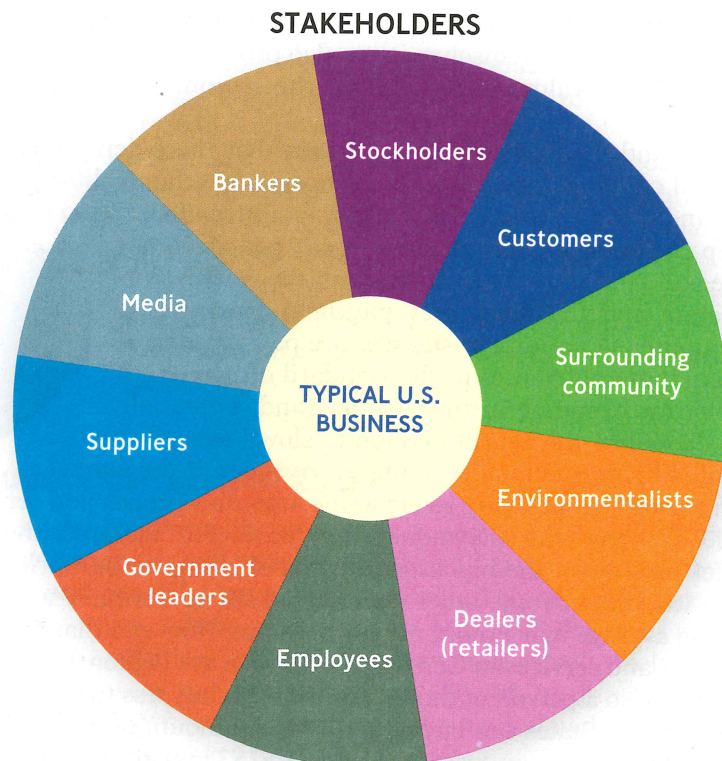
Stakeholders are all the people who stand to gain or lose by the policies and activities of a business and whose concerns the business needs to address.⁸ They include customers, employees, stockholders, suppliers, dealers (retailers), bankers, people in the surrounding community, the media, environmentalists, and elected government leaders (see Figure 1.1).

A primary challenge for organizations of the 21st century will be to recognize and respond to the needs of their stakeholders. For example, the need for the business to make profits may be balanced against the needs of employees to earn sufficient income or the need to protect the environment.⁹ Ignore the media, and they might attack your business with articles that hurt sales. Oppose the local community, and it may stop you from expanding.

figure 1.1

A BUSINESS AND ITS STAKEHOLDERS

Often the needs of a firm's various stakeholders will conflict. For example, paying employees more may cut into stockholders' profits. Balancing such demands is a major role of business managers.



Staying competitive may call for outsourcing. **Outsourcing** means contracting with other companies (often in other countries) to do some or all the functions of a firm, like its production or accounting tasks. Outsourcing has had serious consequences in some states where jobs have been lost to overseas competitors. We discuss outsourcing in more detail in Chapter 3.

The other side of the outsourcing coin is *insourcing*.¹⁰ Many foreign companies are setting up design and production facilities here in the United States. For example, Korea-based Hyundai operates design and engineering headquarters in Detroit, Michigan, and produces cars in Montgomery, Alabama. Japanese automakers Honda and Toyota have been producing cars in the United States for years. Insourcing creates many new U.S. jobs and helps offset those being outsourced.¹¹

It may be legal and profitable to outsource, but is it best for all the stakeholders? Business leaders must make outsourcing decisions based on all factors. Pleasing stakeholders is not easy and often calls for trade-offs.

Using Business Principles in Nonprofit Organizations

Despite their efforts to satisfy their stakeholders, businesses cannot do everything needed to make a community all it can be. Nonprofit organizations—such as public schools, civic associations, charities like United Way and Salvation Army, and groups devoted to social causes—also make a major contribution to the welfare of society. A **nonprofit organization** is an organization whose goals do not include making a personal profit for its owners or organizers. Nonprofit organizations often do strive for financial gains, but they use them to meet their social or educational goals rather than for personal profit.¹²

Social entrepreneurs are people who use business principles to start and manage not-for-profits and help address social issues. Muhammad Yunus won the Nobel Prize for starting the Grameen Bank, a microlending organization that provides small loans to entrepreneurs too poor to qualify for traditional loans. Yunus has started 30 of what he calls social businesses that do not have profit as their goal. One, for example, provides cataract operations for a fraction of the usual cost.¹³



outsourcing

Contracting with other companies (often in other countries) to do some or all of the functions of a firm, like its production or accounting tasks.

nonprofit organization

An organization whose goals do not include making a personal profit for its owners or organizers.

The goals of nonprofit organizations are social and educational, not profit-oriented. The Red Cross, for instance provides assistance to around 30 million people annually from refugees to victims of natural disasters. Why do good management principles apply equally to businesses and nonprofit organizations?