Resumen en español

Spotlight VIDEOS

CHAPTER 3

Business Organizations

Why It Matters

You have an idea for a new product and you want to set up a company to market it. You need $5,000 to get started with production and advertising. Use what you have already learned about the factors of production to create a list of resources you will need and where to find them. Read Chapter 3 to learn about the different ways to organize a business.

The BIG Ideas

1. The profit motive acts as an incentive for people to produce and sell goods and services.
2. Governments and institutions help participants in a market economy accomplish their financial goals.

Businesses can be owned by individuals such as this flower shop owner, by two or more partners, or by many stockholders of a large company.

Tony Anderson/Getty Images

Economics ONLINE **Chapter Overview** Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 3—Chapter Overviews* to preview chapter information.

SECTION 1

Forms of Business Organization

GUIDE TO READING

Section Preview

In this section, you will learn about the advantages and disadvantages of various forms of business organization.

Content Vocabulary

- sole proprietorship *(p. 62)*
- proprietorship *(p. 62)*
- unlimited liability *(p. 63)*
- inventory *(p. 64)*
- limited life *(p. 64)*
- partnership *(p. 64)*
- general partnership *(p. 64)*
- limited partnership *(p. 64)*
- corporation *(p. 67)*
- charter *(p. 67)*
- stock *(p. 67)*
- stockholder *(p. 67)*
- shareholder *(p. 67)*
- dividend *(p. 67)*
- common stock *(p. 67)*
- preferred stock *(p. 68)*
- bond *(p. 69)*
- principal *(p. 69)*
- interest *(p. 69)*
- double taxation *(p. 69)*

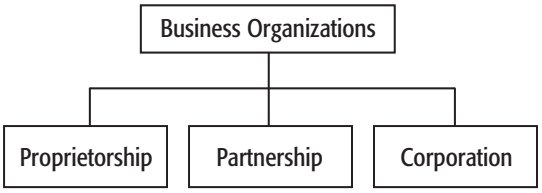
Academic Vocabulary

- comprise *(p. 62)*
- entity *(p. 63)*

Reading Strategy

Contrasting As you read about business organizations, complete a graphic organizer similar to the one below to show how the three types of business organizations differ from one another.

Interactive Graphic Organizer



COMPANIES IN THE NEWS

–adapted from *BusinessWeek*

Selling to a Different Beat

Marc Weinstein's Amoeba Music store stocks 2.5 million titles, half of which are rare and used vinyl records. With genres ranging from jazz and hip-hop to Hungarian folk music and Pakistani *qawwali*, Amoeba is Weinstein's alternative to music megastores.

Amoeba's 1990 launch in Berkeley, California, was risky. Still, Weinstein and his two partners staked $325,000 in loans and savings on their vision. The risk yielded sales of $10,000 on opening day. Today the business has stores in Los Angeles and San Francisco. And while most of the industry faces declining sales, Amoeba's sales continue to rise.

For Weinstein and company, the vision is evolving. Soon Amoeba will have its own record label and launch a Web site for music downloads. ■

There are three main forms of business organization in the economy today—the sole proprietorship, the partnership, and the corporation. Each offers its owners significant advantages and disadvantages.

The type of business an entrepreneur decides on can have real consequences. If Marc Weinstein and his co-founders had organized as a corporation instead of a partnership, then the corporation would have to please its stockholders. Instead, the business was organized as a partnership, which allows the partners to set their own criteria for success.

Marianna Day Massey/ZUMA Press

sole proprietorship or **proprietorship** business owned and run by a single person who has the rights to all profits and unlimited liability for all debts of the firm

Skills Handbook

*See page **R50** for more information on **Using Bar and Circle Graphs.***

Sole Proprietorships

MAIN Idea Sole proprietorships are easy to start, but owners have unlimited liability.

Economics & You Have you ever dreamed of starting your own business? Read on to learn what it takes to own a business.

The most common form of business organization in the United States is the **sole proprietorship** or **proprietorship**—a business owned and run by a single individual. Because proprietorships are basically one-person operations, they **comprise** the smallest form of business and have the smallest fraction of total sales. As **Figure 3.1** shows, they are also relatively profitable, as they bring in about one-fifth of the total profits earned by all businesses.

Forming a Proprietorship

The sole proprietorship is the easiest form of business to start because it involves almost no requirements except for occasional business licenses and fees. Most proprietorships are ready for business as soon as they set up operations. You could start a proprietorship simply by putting up a lemonade stand in your front yard. Someone else could decide to mow lawns or open a restaurant. A proprietorship can be run on the Internet, out of a garage, or from an office in a professional building.

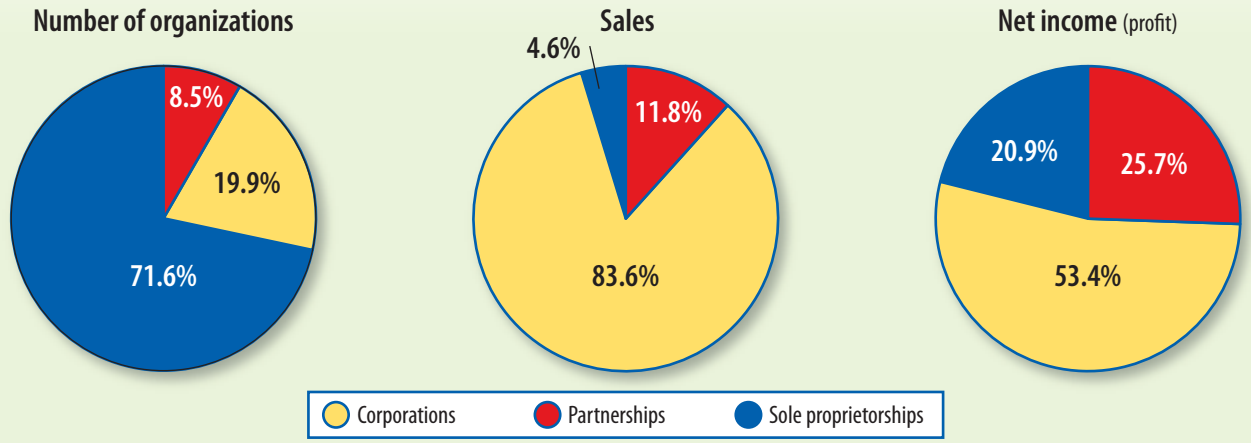
Advantages

As you have learned, a sole proprietorship is easy to start up. If someone has an idea or an opportunity to make a profit, he or she only has to decide to go into business and then do it.

Management also is relatively simple. Decisions do not require the approval of a co-owner, boss, or other "higher-up." This flexibility means that the proprietor can make an immediate decision if a problem comes up.

A third advantage is that the owner can keep the profits of successful management without having to share them with other owners. The owner also has to accept the possibility of a loss, but the lure of profits makes people willing to take risks.

Figure 3.1 ▶ **Business Organizations**



Source: *2006 Statistical Abstract of the United States.*

▶ Businesses in the United States can be organized as sole proprietorships, partnerships, or corporations. Their numbers, sales, and profits vary widely. Corporations make up only 20 percent of businesses, yet they account for over half of the total net income.

Economic Analysis ***Which business organization accounts for the largest amount of sales?***

Sole Proprietorship Anyone can start a business as a sole proprietor, as this pharmacist has done. ***What are the advantages of sole proprietorships?***

Fourth, the proprietorship does not have to pay separate business income taxes because the business is not recognized as a separate legal **entity.** The owner still must pay individual income taxes on profits taken from the sole proprietorship, but the business itself is exempt from any tax on income.

Suppose, for example, Mr. Winters owns and operates a small hardware store in a local shopping center and a small auto repair business in his garage next to his home. Because neither business depends on the other, and because the only thing they have in common is Mr. Winters's ownership, the two businesses appear as separate and distinct economic activities. For tax purposes, however, everything is lumped together at the end of the year. When Mr. Winters files his personal income taxes, the profits from both businesses are combined with any wages and salaries from other sources. He does not pay taxes on either of the businesses separately.

Another advantage of the proprietorship is the psychological satisfaction many people get from being their own boss. These people often have a strong desire to see their name in print, have dreams of great wealth or community status, or simply want to make their mark in history.

A sixth advantage is that it is easy to get out of business. All the proprietor has to do is pay any outstanding bills and then stop offering goods or services for sale.

Disadvantages

The main disadvantage of a proprietorship is that the owner of the business has **unlimited liability.** This means that the owner is personally and fully responsible for all losses and debts of the business. If the business fails, the owner's personal possessions may be taken away to satisfy business debts.

unlimited liability requirement that an owner is personally and fully responsible for all losses and debts of the business

As an example, let us revisit the earlier case of Mr. Winters, who owns and operates two businesses. If the hardware business should fail, his personal wealth, which includes the automobile repair shop, may be legally taken away to pay off debts arising from the hardware store.

A second disadvantage of a proprietorship is the difficulty of raising financial capital. Generally, a large amount of

Getty Images

inventory stock of finished goods and parts held in reserve

limited life situation in which a firm ceases to exist when an owner dies, quits, or sells the business

partnership unincorporated business owned and operated by two or more people who share the profits and responsibility for debts

general partnership form of partnership where all partners are equally responsible for management and debts

limited partnership form of partnership where one or more partners are not active in the daily running of the business and have limited responsibility for debts

money is needed to set up a business, and even more may be required for its expansion. However, banks and other lenders are often reluctant to lend money to new or very small businesses. As a result, the proprietor often has to raise financial capital by tapping savings, using credit cards, or borrowing from friends and family.

The size and efficiency of a proprietorship also are disadvantages. A retail store, for example, may need to hire several employees just to stay open during normal business hours. It may also have to carry a minimum **inventory**—a stock of finished goods and parts in reserve—to satisfy customers or to keep production flowing smoothly. Because of limited financial capital, the proprietor may not be able to hire enough personnel or stock enough inventory to operate the business efficiently.

A fourth disadvantage is that the proprietor often has limited managerial experience. The owner-manager of a small company may be an inventor who is highly qualified as an engineer but lacks the "business sense" or the time needed to oversee the growth of the company. This owner may have to hire others to do the types of work—manufacturing, sales, and accounting—at which he or she is not an expert.

A fifth disadvantage is the difficulty of attracting qualified employees. Because proprietorships tend to be small, employees often have to be skilled in several areas. In addition, many top high school and college graduates are more likely to be attracted to positions with larger, well-established firms than small ones. This is especially true when larger firms offer *fringe benefits*—employee benefits such as paid vacations, sick leave, retirement, and health or medical insurance—in addition to wages and salaries.

A sixth disadvantage of the sole proprietorship is **limited life.** This means that the firm legally ceases to exist when the owner dies, quits, or sells the business.

✓Reading Check **Describing** What are the major disadvantages of a sole proprietorship?

Partnerships

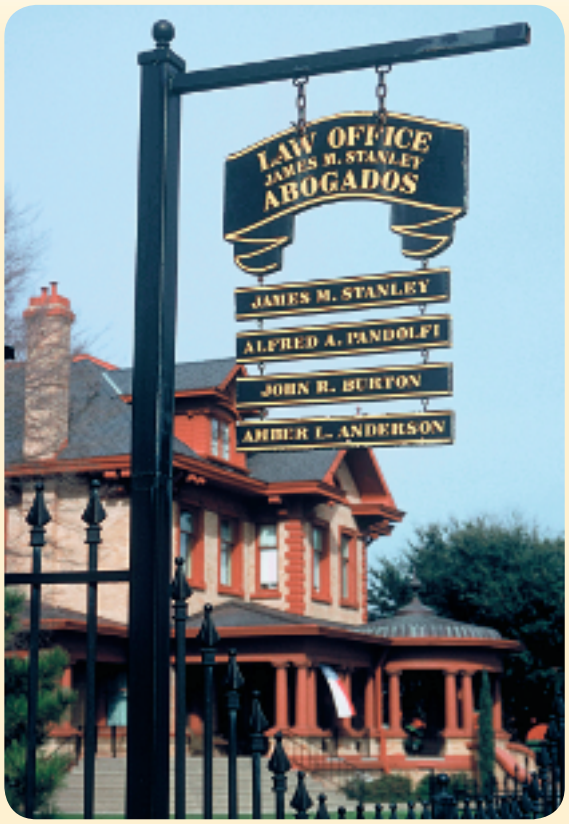
MAIN Idea In a partnership, each partner fully shares responsibility for the operation of the business and all profits or losses.

Economics & You Have you ever had a partner for a school project? How did you handle individual tasks, and how were grades assigned? Read on to find out about issues associated with partnerships.

A **partnership** is a business that is jointly owned by two or more persons. It shares many of the same strengths and weaknesses of a sole proprietorship. As shown in Figure 3.1, partnerships are the least numerous form of business organization in the United States, accounting for the second smallest proportion of sales and net income.

Types of Partnerships

The most common form of partnership is a **general partnership,** in which all partners are responsible for the management and financial obligations of the business. In a **limited partnership,** at least one partner is not active in the daily running of the



Annette Coolidge/PhotoEdit

business. Likewise, the limited partner only has limited responsibility for the debts and obligations of the business.

Forming a Partnership

Like a proprietorship, a partnership is relatively easy to start. Because more than one owner is involved, formal legal papers called *articles of partnership* are usually drawn up to specify arrangements between partners. Although not always required, these papers state ahead of time how the expected profits (or possible losses) will be divided.

The articles of partnership may specify that the profits be divided equally or by any other arrangement suitable to the partners. They also may state the way future partners can be added to the business, and the way the property of the business will be distributed if the partnership ends.

Advantages

Like the sole proprietorship, one advantage of the partnership is its ease of startup. Even the costs of the articles of partnership, which normally involve attorney fees and a filing fee for the state, are minimal if they are spread over several partners.

Ease of management is another advantage. Each partner usually brings a different area of expertise to the business: one might have a talent for marketing, another for production, another for bookkeeping and finance, and yet another for shipping and distribution. While partners normally agree ahead of time to consult with each other before making major decisions, partners generally have a great deal of freedom to make minor ones.

A third advantage is the lack of special taxes on a partnership. As in a proprietorship, the partners withdraw profits from the firm and then pay individual income taxes on them at the end of the year. Partners have to submit special schedules to the Internal Revenue Service detailing their profits from the partnership, but this is for informational purposes only and does not give a partnership any special legal status.

Fourth, partnerships can usually attract financial capital more easily than proprietorships. They are generally larger and

Partnerships Businesses owned by two or more people are called partnerships. Lawyers, doctors, and architects often form partnerships to limit overhead costs.
How are partnerships founded?

(l) Corbis, (r) Doug Menuez/Getty Images

Liability In a partnership, all partners take on responsibility for the debts of the business. ***How do general partnerships and limited partnerships differ?***

www.CartoonStock.com

"Congratulations on becoming a partner - your share of company losses are $200,000."

have a better chance of getting a bank loan. The existing partners could also take in new partners who bring financial capital with them as part of their price for joining.

A fifth advantage of partnerships is the more efficient operations that come with their slightly larger size. In some areas, such as medicine and law, a relatively small firm with three or four partners might be just the right size for the market. Other partnerships, such as accounting firms, may have hundreds of partners offering services throughout the United States.

A sixth and final advantage is that partnerships often find it easier to attract top talent than proprietorships. Because most partnerships offer specialized services, top graduates seek out stable, well-paying firms to apply their recently acquired skills.

Disadvantages

The main disadvantage of the *general partnership* is that each partner is fully responsible for the acts of all other partners. If one partner causes the firm to suffer a huge loss, each partner is fully and personally responsible for the loss. This is similar to the unlimited liability feature of a proprietorship, but it is more complicated because more owners are involved. As a result, most people are extremely careful when they choose a business partner.

In the case of the *limited partnership,* a partner's responsibility for the debts of the business is limited by the size of his or her investment in the firm. If the business fails and debts remain, the limited partner loses only the original investment, leaving the general partners to make up the rest.

Another disadvantage is that the partnership, like the proprietorship, has limited life. When a partner dies or leaves, the partnership must be dissolved and reorganized. However, the new partnership may try to reach an agreement with the older partnership to keep its old name.

A third disadvantage is the potential for conflict between partners. Sometimes partners discover that they do not get along, so they have to either learn to work together or leave the business. If the partnership is large, these types of problems can easily develop, even though initially everyone thought they would get along.

✓**Reading Check** **Contrasting** What are the differences between a general partnership and a limited partnership?

Corporations

MAIN Idea Corporations are one of the most important forms of business and can easily raise large amounts of financial capital.

Economics & You Do you know someone who works for a corporation? Read on to learn how corporations are organized.

Corporations account for only about one-fifth of the businesses in the United States, as shown in Figure 3.1, although they are responsible for a majority of all sales. A **corporation** is a form of business organization recognized by law as a separate legal entity with all the rights of an individual. This status gives the corporation the right to buy and sell property, to enter into legal contracts, and to sue and be sued.

Forming a Corporation

Unlike a sole proprietorship or partnership, a corporation is a very formal and legal arrangement. People who want to *incorporate,* or form a corporation, must file for permission from the national government or the state where the business will have its headquarters. If approved, a **charter**—a government document that gives permission to create a corporation—is granted. The charter states the company's name, address, purpose, and other features of the business.

The charter also specifies the number of shares of **stock,** or ownership certificates in the firm. These shares are sold to investors, called **stockholders** or **shareholders.** As shown in **Figure 3.2,** stockholders then own a part of the corporation. The money gained from the sale of stock is used to set up the corporation. If the corporation is profitable, it may eventually issue a **dividend**—a check that transfers a portion of the corporate earnings—to each stockholder.

Corporate Structure

When investors purchase stock, they become owners with certain ownership rights. The extent of these rights depends on the type of stock purchased: common or preferred.

Common stock represents basic ownership of a corporation. The owner of common stock usually receives one vote for each share of stock. This vote is used to elect a board of directors, which in turn directs the corporation's business by setting broad policies and goals. The board also hires a professional management team to run the business on a daily basis.

corporation form of business organization recognized by law as a separate legal entity

charter written government approval to establish a corporation

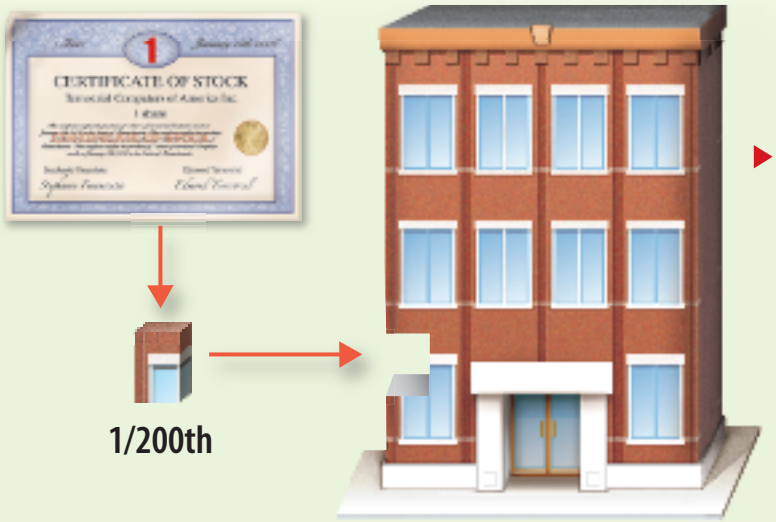
stock certificate of ownership in a corporation

stockholders or **shareholders** people who own a share or shares of stock in a corporation

dividend check that transfers a portion of the company profits to stockholders, usually quarterly

common stock most frequently used form of corporate ownership, with one vote per share for stockholders

Figure 3.2 ▶ Stock Ownership



▶ If a corporation has 200 shares of stock, and if you could divide the firm into 200 equal parts, the owner of a single share of stock would own 1/200th of the corporation.

Economic Analysis ***How does common stock differ from preferred stock?***

preferred stock form of corporate ownership without vote, in which stockholders get their investments back before common stockholders

Preferred stock represents nonvoting ownership shares of the corporation. Because the stock is nonvoting, preferred stockholders do not have the right to elect members to the board of directors. However, preferred stockholders receive their dividends before common stockholders receive theirs. If a corporation goes out of business, preferred stockholders get their investment back before common stockholders get theirs back.

In theory, a stockholder who owns a majority of a corporation's common stock can elect board members and control the company. In some cases, the common stockholder might elect himself or herself, or even other family members, to the board of directors.

In practice, this is not done very often because most corporations are so large and the number of shares held by the typical stockholder is so small. Most small stockholders either do not vote or they turn their votes over to someone else. This is done with the use of a *proxy,* a ballot that gives a stockholder's representative the right to vote on corporate matters.

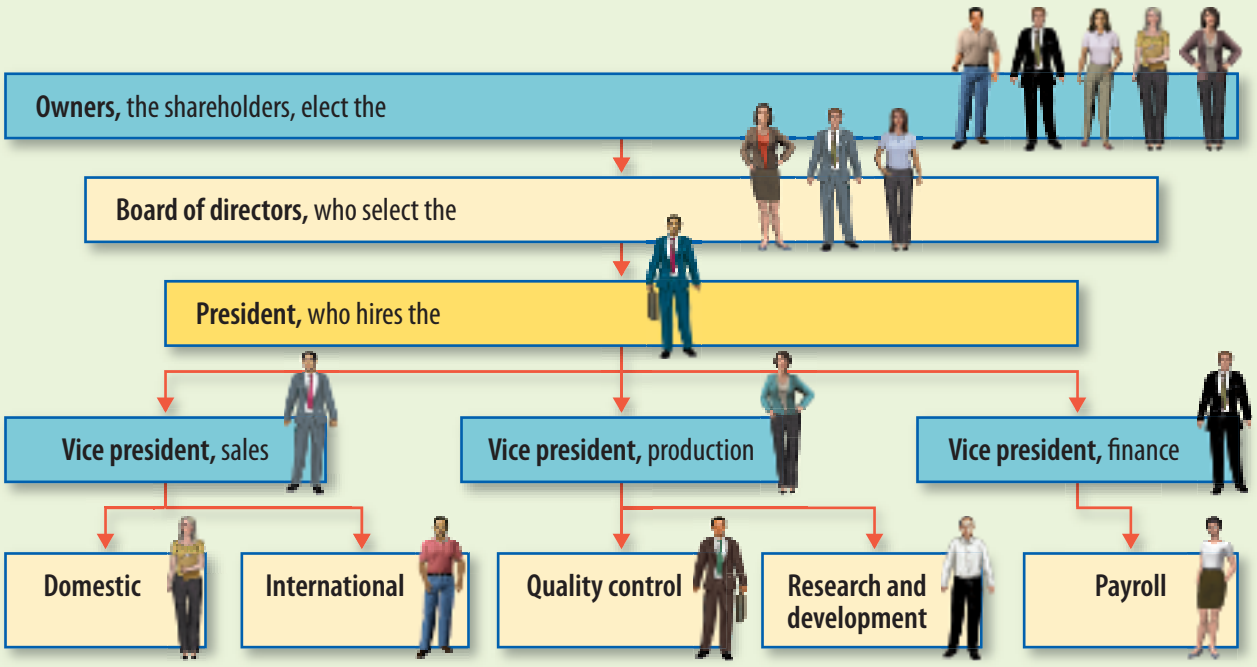
Although corporations differ in size and industry, they generally organize in similar ways. As **Figure 3.3** shows, the day-to-day operations of a corporation are divided into different departments headed by vice presidents, who in turn report to the president of the company. Neither the president nor the other employees of the corporation have direct contact with the owners, or shareholders, of the company.

Advantages

The main advantage of a corporation is the ease of raising financial capital. If the corporation needs more capital, it can sell additional stock to investors. The revenue

Charts In Motion
See StudentWorks™ Plus or glencoe.com.

Figure 3.3 ▶ **Corporate Structure**



▶ This organizational chart shows the chain of command of a typical organization. It also outlines the basic components of the business, such as sales, production, and payroll.

Economic Analysis ***Who reports directly to the vice president of production?***

can then be used to finance or expand operations. A corporation may also borrow money by issuing bonds. A **bond** is a written promise to repay the amount borrowed at a later date. The amount borrowed is known as the **principal.** While the money is borrowed, the corporation pays **interest,** the price paid for the use of another's money.

A second and very important advantage is that the corporation provides *limited liability* for its owners. This means that the corporation itself, not its owners, is fully responsible for its obligations. To illustrate, suppose a corporation cannot pay all of its debts and goes out of business. Because of limited liability, stockholder losses are limited to the money they invested in stock. Even if other debts remain, stockholders are not responsible for them.

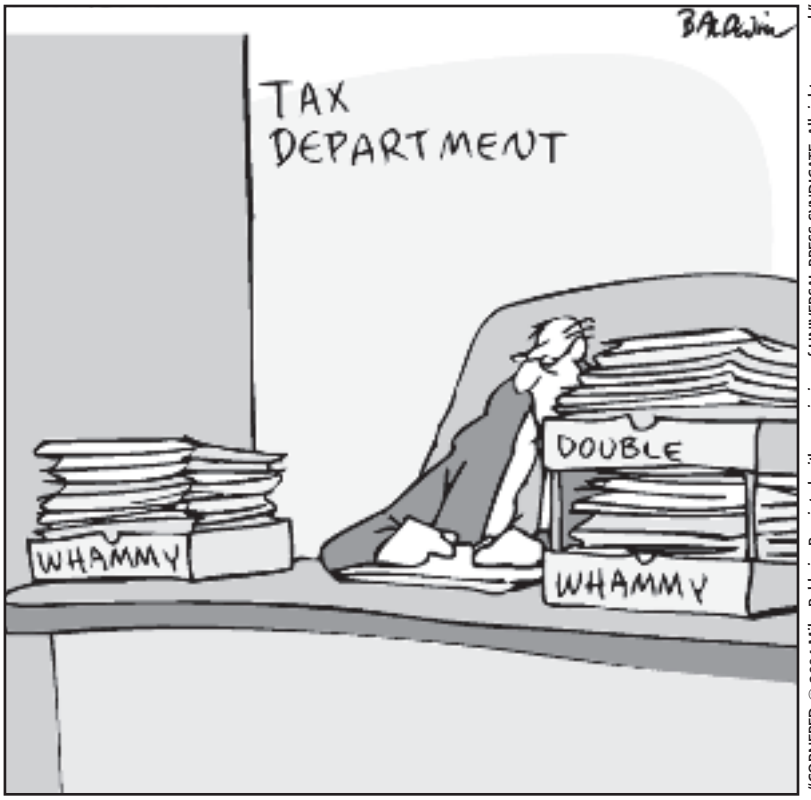
Some firms will incorporate just to take advantage of the limited liability. For example, suppose Mr. Winters, who owns the hardware store and the auto repair business, now decides to set up each business as a separate corporation. If the hardware business should fail, his personal wealth, which includes stock in the automobile repair business, is safe. Mr. Winters may lose all the money invested in the hardware business, but that would be the extent of his loss.

From a broader economic perspective, limited liability enables firms to undertake potentially profitable ventures which are inherently risky. For example, corporations rather than individuals usually introduce new medicines because of the limited liability feature.

A third advantage of a corporation is that the directors of the corporation can hire professional managers to run the firm. This means that the owners, or stockholders, can own a portion of the corporation without having to know much about the business itself.

Another advantage is unlimited life, meaning that the corporation continues to exist even when ownership changes. Because the corporation is recognized as a separate legal entity, the name of the company stays the same, and the corporation continues to do business.

Cornered by Mike Baldwin



Double Taxation Shareholders have to pay corporate taxes and income taxes on their dividends. ***Why are people interested in owning stock when they have to pay so much in taxes?***

This leads to a fifth advantage, the ease of transferring ownership of the corporation. If a shareholder no longer wants to be an owner, he or she simply sells the stock to someone else who then becomes the new owner. As a result, it is easier for the owner of a corporation to find a new buyer than it is for the owner of a sole proprietorship or a partnership.

Disadvantages

Because the law recognizes the corporation as a separate legal entity, the corporation must keep detailed sales and expense records so that it can pay taxes on its profits. This leads to the first disadvantage, the **double taxation** of corporate profits. Double taxation means that stockholder dividends are taxed twice. They are taxed the first time when the corporation pays taxes on its profits. Then they are taxed a

bond formal contract to repay borrowed money with interest

principal amount borrowed when getting a loan or issuing a bond

interest payment made for the use of borrowed money

double taxation taxation of dividends both as corporate profit and as personal income

Did You Know?

What's a public corporation anyway? It's one that has "gone public," which means anyone with a little extra cash can buy stock and own a part of the company. A *privately held corporation,* on the other hand, sells shares only to a select group of people. Sometimes that group may consist of a few family members. The Securities and Exchange Commission (SEC) was set up in 1934 to regulate the sale of stock by public corporations.

Skills Handbook

*See page **R41** for more information on **Evaluating Information.***

second time when investors, as the owners of the corporation, report their dividends as personal income.

Another disadvantage of the corporate structure is the difficulty and expense of getting a charter. Depending on the state, attorney's fees and filing expenses can cost several thousand dollars.

A third disadvantage of the corporation is that the owners, or shareholders, have little voice in how the business is run. Shareholders vote for the board of directors, and the directors turn day-to-day operations over to a professional management team. The result is a separation of ownership and management. This is different from the proprietorship and partnership, where ownership and management are usually one and the same.

Finally, the fourth disadvantage is that corporations are subject to more government regulation than other forms of business. Corporations must register with the state in which they are chartered. If a corporation wants to sell its stock to the public, it must register with the federal Securities and Exchange Commission (SEC). It will also have to provide financial information concerning sales and profits to the general public on a regular basis. Even an attempt to take over another business may require federal government approval.

Reading Check **Evaluating** Why do many business owners prefer corporations over other forms of business organization?

SECTION 1 Review

Vocabulary

1. **Explain** the significance of sole proprietorship, proprietorship, unlimited liability, inventory, limited life, partnership, general partnership, limited partnership, corporation, charter, stock, stockholder, shareholder, dividend, common stock, preferred stock, bond, principal, interest, and double taxation.

Main Ideas

2. **Discuss** the advantages and disadvantages of the corporation.
3. **Describing** Use a graphic organizer like the one below to describe the characteristics of proprietorships, partnerships, and corporations.

Business Form	Characteristics
Proprietorship	
Partnership	
Corporation	

Critical Thinking

4. **The BIG Idea** How do partnerships support the profit motive of entrepreneurs?
5. **Analyzing Visuals** Look at Figure 3.3 on page 68. What is the relationship between the owners and the employees of the corporation?
6. **Drawing Conclusions** When a corporation wants to introduce a potentially profitable but risky product, it frequently sets up a separate company that has its own corporate structure. Why do you think the corporation does this?

Applying Economics

7. **Partnerships** Assume that you and a friend want to start a partnership to run your own business, such as a music store. Draw up one-page articles of partnership that outline how you will address financial issues of the partnership.

Interactive Graphic Organizer

ENTREPRENEUR

Profiles in Economics

Andrea Jung (1958–)

- first female chief executive officer (CEO) in Avon Products' 118-year history
- ranked #5 on *Fortune* magazine's "50 Most Powerful Women in Business"

The Avon Lady

When promoted to Avon's top spot in 1999, Andrea Jung was charged with modernizing and restructuring what many considered to be a hopelessly antiquated company. Women have been selling Avon cosmetics directly to customers since 1886, but in the Internet era, this hands-on business model became a liability. If women had no Avon representative in their area, they had no way to purchase the products from the catalog—until Andrea Jung took charge.

The Mobilization Campaign

Jung faced a problem. Putting Avon products in retail stores or offering them online put the company in direct competition with its own army of 5 million independent sales representatives in 140 countries. Working closely with the "reps" was paramount to Jung. So when Jung took the company online, she made sure it directed users to local reps. She also gave the reps the opportunity to purchase kiosks in malls and other retail venues as franchises. Fluent in Mandarin Chinese, she helped strengthen Avon's presence in China and other countries, such as Russia. She also updated and innovated products and introduced a new line, called Mark™ that was tailored to the increasing number of younger, college-aged reps and their customers. These changes and others caused a rebound in Avon stock, led to increases in annual revenues from $5.3 billion to more than $8 billion, and made Jung a corporate celebrity.

Jung also had an impact within the company. Avon has more women in management—86 percent—than any other Fortune 500 company. Jung serves as a mentor to other women in the company. She encourages questions and rewards success. Although she is a private person, Jung has learned to be more open with Avon reps and motivate them to enact the changes she sees ahead.

After graduating from Princeton with a degree in English literature, Andrea Jung wanted to spend just two years in retail before pursuing a law degree. Instead, she turned retail into a career—and Avon into a global success.

Examining the Profile

1. **Summarizing** What changes did Jung make to Avon's marketing strategy?
2. **For Further Research** What career steps did Jung take that allowed her to move from a degree in English literature to a top management position?

Nancy Kaszerman/Corbis

SECTION 2

Business Growth and Expansion

GUIDE TO READING

Section Preview

In this section, you will learn how businesses grow through merging with other companies or by reinvesting profits in themselves.

Content Vocabulary

- merger *(p. 72)*
- income statement *(p. 73)*
- net income *(p. 73)*
- depreciation *(p. 73)*
- cash flow *(p. 73)*
- horizontal merger *(p. 75)*
- vertical merger *(p. 75)*
- conglomerate *(p. 76)*
- multinational *(p. 76)*

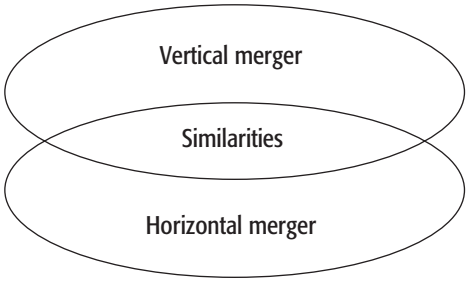
Academic Vocabulary

- internally *(p. 75)*
- dominant *(p. 75)*

Reading Strategy

Comparing As you read the section, complete a graphic organizer similar to the one below by comparing a vertical merger to a horizontal merger.

Interactive Graphic Organizer



COMPANIES IN THE NEWS

–Newsweek

Reinvesting for Monster Growth

How does a booming company spark new growth the year *after* its sales nearly double? If you're Hansen Natural, maker of Monster Energy drinks, you start by signing a two-year endorsement deal with Ricky Carmichael, the Michael Jordan of motocross and supercross racing. It's good for business when "R.C." hoists a can of Monster on the victory stand.

. . .[A] big endorsement deal is just one way Hansen hopes to build on its growth. CEO Rodney Sacks [and fellow South African-born company president Hilton Schlosberg] wants to roll out new products that reach . . . the key male market of 18- to 25-year-olds. In addition to regular Green Monster, there's . . . Monster Assault in a camouflage can aimed at teens and a Lost Energy brand targeting surfers and skateboarders. ■

merger combination of two or more businesses to form a single firm

When Hansen Natural decided to sign up a celebrity to endorse its products, the company hoped to increase profits by expanding its markets and sales. Investing these profits in new plant, equipment, and products is one way a business can grow.

Another way a business can expand is by engaging in a **merger**—a combination of two or more businesses to form a single firm. Yet mergers can be risky because they often combine very different corporate cultures, and there is no guarantee that consumers will like the resulting products. Even so, the payoffs can be huge, so the temptation to merge is always attractive to businesses.

Growth Through Reinvestment

MAIN Idea Business owners can use their profits to update and expand their firms.

Economics & You Do you know a local business that has expanded in recent years? Read on to learn how business owners reinvest cash flow for growth.

Most businesses use financial statements to keep track of their business operations. One of the most important of those is the **income statement**—a report showing a business's sales, expenses, net income, and cash flows for a period of time, such as three months or a year. We can use the income statement to show how a business can use some of the revenue it receives from sales to grow through reinvestment.

Estimating Cash Flows

An income statement such as the one in **Figure 3.4** shows a firm's **net income**—the funds left over after all of the firm's expenses, including taxes, are subtracted from its sales. These expenses include the cost of inventory, wages and salaries, interest payments, and all other payments the firm must make as part of its normal business operations. One of the most important of these payments is **depreciation**—a noncash charge the firm takes for the general wear and tear on its capital goods.

Depreciation is called a *noncash charge* because the money stays in the firm rather than being paid to someone else. For example, interest may be paid to a bank, wages may be paid to employees, or payments may be made to suppliers to provide some of the inputs used in production. However, the money allocated to depreciation never goes anywhere. Since this money stays in the business, the firm treats it as a form of income. Because of this, firms usually prefer to take as much depreciation as possible. As you can see in the figure, an incease in depreciation would lower the earnings before tax but increase the cash flow.

The **cash flow**—the sum of net income and noncash charges, such as depreciation—is the *bottom line*, a more comprehensive measure of profits. This is because the cash flow represents the total amount of new funds generated from operations.

Reinvesting Cash Flows

If the business has a positive cash flow, the owners can then decide how to allocate it. The board of directors of a corporation

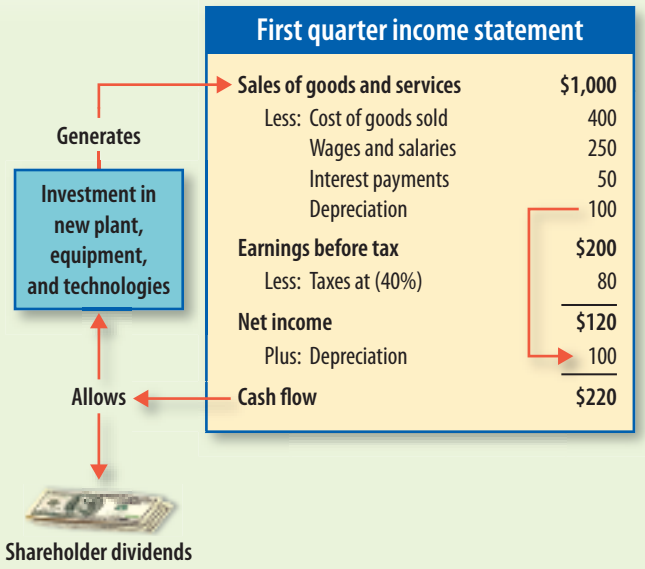
income statement report showing a firm's sales, expenses, net income, and cash flows for a certain period, usually three months or a year

net income common measure of business profits determined by subtracting all expenses, including taxes, from revenues

depreciation gradual wear on capital goods

cash flow total amount of new funds a business generates from operations

Figure 3.4 ▶ Growth Through Reinvestment



First quarter income statement	
Sales of goods and services	$1,000
Less: Cost of goods sold	400
Wages and salaries	250
Interest payments	50
Depreciation	100
Earnings before tax	$200
Less: Taxes at (40%)	80
Net income	$120
Plus: Depreciation	100
Cash flow	$220

In Motion

Charts in Motion

See StudentWorks™ Plus or glencoe.com.

▶ Businesses use income statements to record sales and expenses. Cash flow includes the net income plus depreciation. Any cash flow not paid out to stockholders as dividends is money that businesses can use for reinvestment.

Economic Analysis ***Which of the items on the income statement represents the real measure of profits for the business?***

may declare a dividend to be paid directly to shareholders as a reward for their investments. The owners of a proprietorship or partnership may keep some cash flow as the reward for risk-taking. The remainder of the funds could then be reinvested in new plant, equipment, or technologies.

When cash flows are reinvested in the business, the firm can produce additional products. This generates additional sales and an even larger cash flow during the next sales period. As long as the firm has positive cash flows, and as long as the reinvested funds are larger than the wear and tear on equipment, the firm will grow.

Finally, the concept of cash flow is also important to investors. In fact, if investors want to know about the financial health of a firm, a positive cash flow is one of the first things they look for.

✓Reading Check **Summarizing** What is the benefit of reinvesting cash flow in a business?

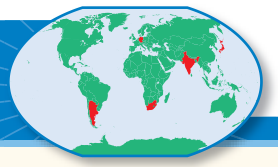
Growth Through Mergers

MAIN Idea Mergers allow firms to quickly grow in size.

Economics & You Can you think of any recent mergers and the issues those mergers raised? Read on to learn about the various types of mergers.

When two companies merge, one gives up its separate legal identity. For public recognition purposes, however, the name of the new company may reflect the identities of both. When Chase National Bank and Bank of Manhattan merged, the new company was called the Chase Manhattan Bank of New York. Later it changed its name to the Chase Manhattan Corporation to reflect its geographically expanding business. Finally, after merging with JP Morgan, it settled on JPMorgan Chase. Likewise, Procter & Gamble kept the brand name *Gillette* after it bought the company.

The Global Economy & YOU



Know Your Manners

As American businesses expand into other countries, they face a question that has nothing to do with actual business: how to interact with people from a different culture. You too may someday find yourself working in another country or traveling abroad to meet with businesspeople. How will you know what to do and say?

Many books and Web sites offer advice on customs to Americans doing business in other countries. Here are some things to keep in mind as you travel around the globe:

- Gift-giving is an important part of Japanese business protocol. Present your gift with both hands and note that it is of no large value. This tells your business partner that you value the relationship more than the gift itself.
- In Argentina, it is not unusual for a business associate to arrive 30 to 40 minutes late to a meeting.
- The amount of time you spend in negotiations will often determine the importance of a business arrangement in India. More time implies greater importance.
- In Germany, avoid using first names. These are reserved for family and close friends. Even among long-time colleagues, it is common to address one another using titles and last names.
- Local politics are open for discussion in South Africa. In fact, not knowing local and regional politics can end any business dealings.

Figure 3.5 ▶ Types of Mergers

▶ Horizontal mergers combine two or more firms that produce the same kind of product. Vertical mergers bring together firms involved in different stages of manufacturing or marketing.

Economic Analysis ***How does a company benefit from a vertical merger?***

Types of Mergers

There are two types of mergers, both of which are illustrated in **Figure 3.5.** The first is a **horizontal merger**, which takes place when firms that produce the same kind of product join forces. One such example is the bank merger of JP Morgan and Chase Manhattan to form JPMorgan Chase.

When companies involved in different stages of manufacturing or marketing join together, it results in a **vertical merger.** One example of a vertical merger is the formation of the U.S. Steel Corporation. At one time it mined its own ore, shipped it across the Great Lakes, smelted it, and made steel into many different products. Vertical mergers take place when companies seek to protect against the potential loss of suppliers.

Reasons for Merging

Mergers take place for a variety of reasons. A business may seek a merger to grow faster, to become more efficient, to acquire or deliver a better product, to eliminate a rival, or to change its image.

For example, some managers find that they cannot grow as fast as they would like using the funds they generate **internally.** As a result, one firm may consider merging with another firm. Sometimes a merger makes sense, and other times it may not, but the desire to become a larger company in the industry—if not the largest—is one reason that mergers take place.

Efficiency is another reason for mergers. When two firms merge, they no longer need two presidents, two treasurers, and two personnel directors. The new company can have more retail outlets or manufacturing capabilities without significantly increasing management costs. In addition, the new company may be able to get better discounts by making volume purchases, and it may be able to make more effective use of its advertising. Sometimes the merging firms can achieve two objectives at once—such as **dominant** size and improved efficiency.

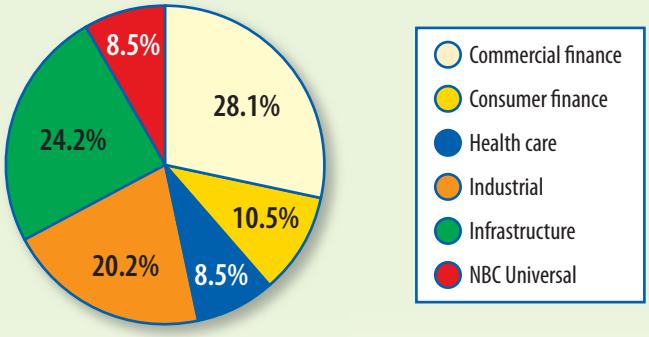
horizontal merger combinationof two or more firms producing the same kind of product

vertical merger combination of firms involved in different stages of manufacturing or marketing

Figure 3.6 ▶ Conglomerate Structure

▶ A conglomerate is a firm with at least four businesses that make unrelated products, none of which is responsible for a majority of its sales. General Electric is a U.S. conglomerate with products ranging from aircraft engines to movies.

Economic Analysis ***How many different industries can you identify in the list of GE products?***



Source: www.ge.com, 2006

photo on top: Engineer working on GE aircraft engine
photo on bottom: Entrance to NBC Universal Studios

conglomerate firm with four or more businesses making unrelated products, with no single business responsible for a majority of its sales

multinational corporation producing and selling without regard to national boundaries and whose business activities are located in several different countries

Some mergers are driven by the desire to acquire new product lines. When a telecommunications company such as AT&T buys a cable TV company, for example, it can offer faster Internet access and telephone service in a single package.

Sometimes firms merge to catch up with, or even eliminate, rivals. Royal Caribbean Cruises acquired Celebrity Cruise Lines and nearly doubled in size to become the second largest cruise line behind Carnival.

Finally, a company may use a merger to *lose* its corporate identity. For example, ValuJet merged with AirWays to form AirTran Holdings Corporation. The new company flew the same planes and routes as the original company, but AirTran hoped the name change would help the public forget ValuJet's tragic Everglades crash in 1996 that claimed 110 lives.

Conglomerates

A corporation may become so large through mergers and acquisitions that it turns into a conglomerate. A **conglomerate** is a firm that has at least four businesses, each making unrelated products and none responsible for a majority of its sales.

Diversification is one of the main reasons for conglomerate mergers. Some firms hope to protect their overall sales and profits by not "putting all their eggs in one basket." Isolated economic events, such as bad weather or a sudden change of consumer tastes, may affect some product lines but not all of them at the same time.

In recent years, the number of conglomerates in the United States has declined. In Asia, however, conglomerates remain strong. Samsung, Gold Star, and Daewoo are still dominant in Korea, as are Mitsubishi, Panasonic, and Sony in Japan.

Multinationals

Other large corporations have become international in scope. A **multinational** is a corporation that has manufacturing or service operations in a number of different countries. In effect, it is a citizen of several countries at one time. A multinational is likely to pay taxes in each country where it has operations and is subject to the laws of each. General Motors,

Nabisco, British Petroleum, Royal Dutch Shell, Mitsubishi, and Sony are examples of multinational corporations that have attained worldwide economic importance.

Multinational corporations are important because they have the ability to move resources, goods, services, and financial capital across national borders. A multinational with its headquarters in Canada, for example, could sell bonds in France. The proceeds could then be used to expand a plant in Mexico that makes products for sale in the United States. A multinational may also be a conglomerate if it makes unrelated products, but it is more likely to be called a multinational if it conducts operations in several different countries.

Multinationals are usually welcome in a nation because they transfer new technology and generate new jobs in areas where jobs are needed. Multinationals also produce tax revenues for the host country, which helps that nation's economy.

At times, multinationals have been known to abuse their power by paying low wages to workers, exporting scarce natural resources, or interfering with the development of local businesses. Some critics point out that multinational corporations are able to demand tax, regulatory, and wage concessions by threatening to move their operations to another country. Other critics are concerned that multinationals may alter traditional ways of life and business customs in the host country.

Most economists, however, welcome the lower-cost production and higher-quality output that global competition brings. They also believe that the transfer of technology that eventually takes place will raise the standard of living for everyone. On balance, the advantages of multinationals far outweigh the disadvantages.

✓Reading Check **Contrasting** How do conglomerates and multinationals differ?

Skills Handbook

*See page **R42** to learn about **Making Inferences.***

SECTION 2 Review

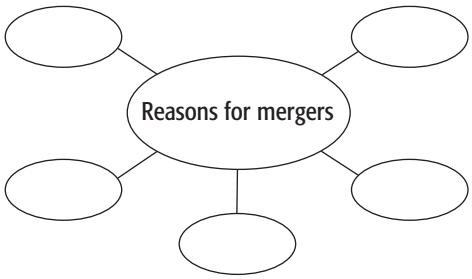
Vocabulary

1. **Explain** the significance of merger, income statement, net income, depreciation, cash flow, horizontal merger, vertical merger, conglomerate, and multinational.

Main Ideas

2. **Describe** how a firm can generate funds internally to grow and expand.
3. **Explain** the basic difference between a conglomerate and a multinational corporation.
4. **Identifying** Use a graphic organizer like the one below to identify the reasons businesses merge.

Interactive Graphic Organizer



Critical Thinking

5. **The BIG Idea** How could a merger between two large cellular phone companies provide better products in a more efficient manner?
6. **Analyzing Visuals** Look at Figure 3.6 on page 76. Explain how the diversification of General Electric illustrates the saying: "Don't put all your eggs in one basket."
7. **Inferring** What are the possible benefits and drawbacks of multinationals to their host countries?

Applying Economics

8. **Horizontal Mergers** Research the ownership of radio stations in a nearby metropolitan area. Are any owned by the same company? Do the stations have the same types of broadcasts or the same advertising? Write a one- to two-page paper about your findings. In your paper, explain why a company would want to own multiple stations in the same geographical market.

Case Study

7-Eleven

"Convenience" Is Born

In 1927 an employee of the Southland Ice Company in Dallas, Texas, began selling milk, bread, and eggs from the ice dock on Sundays and evenings when grocery stores were closed. This sparked the idea for the convenience store. In 1946 the stores were renamed 7-Eleven to reflect their new hours: 7 A.M. to 11 P.M.

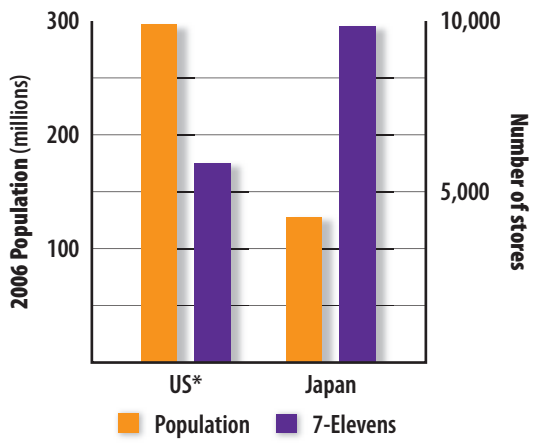
Japan Borrows the Idea

In the early 1970s, Toshifumi Suzuki, a young Japanese executive, came to the United States to look into franchising Denny's restaurants in Japan. He was more impressed by the 7-Elevens he saw. With its densely populated cities and small commercial lots, Japan was perfectly suited to the convenience-store format. In 1974 Suzuki opened a chain of stores under the 7-Eleven name.

Since then, the retailer has changed the way the country shops and eats. Many stores offer banking services, dry-cleaning drop-off, parcel post, mobile-phone recharging, photocopying, and even voter registration. They also stock cheap, high-quality foods, such as gourmet rice balls, exotic salads, and other delicacies customized to local tastes.

Technology, coordinated deliveries, and inventory control have boosted efficiency. The company uses a satellite-based ordering system that includes detailed weather reports. This way, managers know to order more cold noodles on warm days or more fresh produce on rainy days, when customers want to avoid a trip to the grocery store. Today 7-Eleven is Japan's most profitable retailer.

7-Elevens in The United States and Japan



*Number of stores includes 7-Eleven stores in Canada

The Student Buys the Teacher

While 7-Eleven Japan boomed, its U.S. counterpart declined. In the late 1980s, 7-Eleven Japan and its parent company, Ito-Yokado, helped turn around the U.S. stores. They improved the U.S. distribution network and introduced new sandwiches, bakery items, and coffees. In 1991, Ito-Yokado bought 70 percent of the American company outright. Today nearly 30,000 7-Eleven stores generate total sales of more than $43 billion in 17 countries and U.S. territories.

Analyzing the Impact

1. **Drawing Conclusions** How do you know that 7-Eleven is a multinational corporation?
2. **Comparing and Contrasting** In what ways do 7-Elevens in Japan differ from their U.S. counterparts?

SECTION 3

Nonprofit Organizations

GUIDE TO READING

Section Preview

In this section, you will learn about the economic benefits that cooperatives and other nonprofit organizations bring to their members.

Content Vocabulary

- nonprofit organization *(p. 79)*
- cooperative *(p. 80)*
- co-op *(p. 80)*
- credit union *(p. 80)*
- labor union *(p. 81)*
- collective bargaining *(p. 81)*
- professional association *(p. 81)*
- chamber of commerce *(p. 81)*
- Better Business Bureau *(p. 82)*
- public utility *(p. 83)*

Academic Vocabulary

- analyze *(p. 80)*
- devoting *(p. 80)*

Reading Strategy

Describing As you read the section, complete a graphic organizer similar to the one below by describing the benefits of nonprofit organizations.

Interactive Graphic Organizer

Organization	Benefits
Community organization	
Consumer cooperative	

PEOPLE IN THE NEWS

—adapted from American Red Cross *News* online

Katrina Volunteer Vacation

Last semester, they studied textbook disasters. Over their winter break, they helped feed and comfort Hurricane Katrina victims.

Each day, Nellie Afshar, Jemma Binder, Dawn Birk, Zachary Joyce, and graduate student Jessica Walsh from the State University of New York at New Paltz rose before dawn, helped load supplies, spent all day dispensing hot meals in flood-ravaged areas, and then pitched in to clean their vehicles afterward.

Their service fulfilled a field work requirement for a disaster studies practicum, part of SUNY's new disaster studies minor, but the experience was more than that for these students. "You couldn't get me up at 6 A.M. for any other reason," said Joyce, 21. "I wouldn't get up at 6 A.M. to make money. This is the best work I've ever done." ■

Nam Y. Huh/AP/Wide World Photos

Most businesses use scarce resources to produce goods and services in hopes of earning a profit for their owners. Other organizations operate on a "not-for-profit" basis. A **nonprofit organization** works in a businesslike way to promote the collective interests of its members rather than to seek financial gain for its owners.

The American Red Cross is one example of a nonprofit. Like other nonprofits, it relies on volunteers such as the SUNY students for much of its work. In this way, nonprofits and other community and civic organizations can perform useful services with minimal expense and without regard to earning a profit.

nonprofit organization economic organization that operates like a business but does not seek financial gain

cooperative or **co-op** nonprofit association performing some kind of economic activity for the benefit of its members

credit union nonprofit service cooperative that accepts deposits, makes loans, and provides other financial services

Community Organizations and Cooperatives

MAIN Idea A variety of nonprofit organizations provide a wide range of goods and services to communities and members.

Economics & You Have you volunteered for a community organization? Read on to find out how such organizations help their communities.

Community Organizations

Community organizations include schools, churches, hospitals, welfare groups, and adoption agencies. Many of these organizations are legally incorporated to take advantage of unlimited life and limited liability. They are similar to profit-seeking businesses but do not issue stock, pay dividends, or pay income taxes. If their activities produce revenues in excess of expenses, they use the surplus to further their work.

Like for-profit businesses, nonprofit organizations use scarce factors of production. Their work is difficult to **analyze** economically because the value of their efforts is not easy to measure. Still, the large number of these organizations shows that they are important to our economic system.

Cooperatives

A common type of nonprofit organization is the **cooperative**, or **co-op.** A cooperative is a voluntary association formed to carry on some kind of economic activity that will benefit its members. As **Figure 3.7** shows, cooperatives can have a variety of goals. Cooperatives fall into three major categories: consumer, service, and producer.

The *consumer cooperative* is a voluntary association that buys bulk amounts of goods such as food or clothing on behalf of its members. Members usually help keep the cost of the operation down by **devoting** several hours a week or month to the operation. If successful, the co-op is able to offer its members products at prices lower than those charged by regular businesses.

A *service cooperative* provides services such as insurance, credit, or child care to its members, rather than goods. One example is a **credit union**, a financial organization that accepts deposits from, and makes loans to, employees of a particular company or government agency.

Like consumers, producers also can have co-ops. A *producer cooperative* helps members promote or sell their products. In the United States, most cooperatives of this kind are made up of farmers. The co-op helps the farmers sell their crops directly to central markets or to companies that use the members' products. Some co-ops, such as the Ocean Spray cranberry co-op, market their products directly to consumers.

✓Reading Check **Explaining** How does a cooperative work?

Figure 3.7 ▶ Cooperatives

Consumer Cooperatives
- Housing cooperatives
- Discount price clubs
- Bulk foods store

Service Cooperatives
- Credit unions
- Insurance companies
- Babysitting services

Producer Cooperatives
- Farmers marketing cooperatives

▶ Cooperatives are voluntary associations of people formed to carry on some kind of economic activity that will benefit their members.

Economic Analysis ***How do the three kinds of cooperatives differ?***

Labor Unions Workers may join a labor union that represents their interests. ***How do labor unions help their members?***

Labor, Professional, and Business Organizations

MAIN Idea Some nonprofit organizations are formed to promote the interests of workers and consumers.

Economics & You You just learned about nonprofit organizations that help consumers and communities. Read on to find out about groups that support workers and businesses.

Nonprofit organizations are not just limited to co-ops and civic groups. Many other groups also organize this way to promote the interests of their members.

Labor Unions

One important economic institution is the **labor union**, an organization of workers formed to represent its members' interests in various employment matters. The union participates in **collective bargaining** when it negotiates with management over issues such as pay, working hours, health care coverage, vacations, and other job-related matters. Unions also lobby for laws that will benefit and protect their workers.

The largest labor organization in the United States is the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), an association of unions whose members include workers in many different jobs. Other unions, such as the National Education Association for teachers, are independent and represent workers in specific industries.

Professional Associations

Some workers belong to professional societies, trade associations, or academies. Such a **professional association** consists of people in a specialized occupation interested in improving the working conditions, skill levels, and public perceptions of the profession.

The American Medical Association (AMA) and the American Bar Association (ABA) are examples of organizations that include members of specific professions. These groups influence the licensing and training of their members, set standards for conduct, and are actively involved in political issues. Other professional associations represent bankers, teachers, college professors, police officers, and hundreds of other professions.

Business Associations

Businesses also organize to promote their collective interests. Most communities have a local **chamber of commerce**, an organization that promotes the welfare of its member businesses. The typical chamber sponsors activities ranging from educational programs to lobbying for favorable business legislation.

Industry or trade associations represent specific kinds of businesses. Trade associations are interested in shaping the

labor union organization that works for its members' interests concerning pay, working conditions, and benefits

collective bargaining negotiation between union and company representatives over pay, benefits, and other job-related matters

professional association nonprofit organization of professional or specialized workers seeking to improve working conditions, skill levels, and public perception of its profession

chamber of commerce nonprofit organization of local businesses formed to promote their interests

Andrew Lichtenstein/Corbis

Better Business Bureau business-sponsored nonprofit organization providing information on local companies to consumers

government's policy on such economic issues as free enterprise, imports and tariffs, the minimum wage, and new construction.

Some business associations help protect the consumer. The **Better Business Bureau** is a nonprofit organization sponsored by local businesses. It provides general information on companies, maintains records of consumer inquiries and complaints, and offers consumer education programs.

✓Reading Check **Summarizing** How do professional associations help their members?

CAREERS

Sociologist

The Work

* Study the development, interaction, and behavior of social groups, including various social, religious, and business organizations
* Gather firsthand information from people and derive conclusions that can lead to formulating policies that impact educators, lawmakers, administrators, and others committed to resolving social problems
* Knowledge of society and social behavior may be used by companies in product development, marketing, and advertising

Qualifications

* Strong mathematical skills, quantitative research and analysis skills, and the ability to communicate ideas clearly
* Objectivity, an open mind, and systematic work habits
* Master's degree, with a Ph.D. required of sociologists teaching at the university level

Earnings

* Median annual earnings: $57,870

Job Growth Outlook

* Slower than average

Source: *Occupational Outlook Handbook*, 2006–2007 Edition

Government

MAIN Idea The government provides some goods and services while helping to make sure the economy runs smoothly.

Economics & You You read earlier about the role of the government in economic policy. Read on to learn more details about that role.

Although you may not think of it that way, your local, state, or national government actually is a nonprofit economic organization. Sometimes government plays a direct role in the economy, while at other times the role is indirect.

Direct Role of Government

Many government agencies produce and distribute goods and services to consumers, giving government a direct role in the economy. The role is "direct" because the government supplies a good or service that competes with private businesses.

One example of direct involvement is the Tennessee Valley Authority (TVA). The TVA supplies electric power for most of Tennessee and parts of Alabama, Georgia, Kentucky, North Carolina, Virginia, and Mississippi. This power supplier competes directly with other, privately owned, power companies.

Another example is the Federal Deposit Insurance Corporation (FDIC), which insures deposits in our nation's banks. Because the insurance the FDIC supplies could be provided by privately owned insurance companies, the FDIC is also an example of the direct role of government.

Perhaps the best-known government corporation is the U.S. Postal Service (USPS). Originally an executive department called the Post Office Department, the USPS became a government corporation in 1970.

Many of these federal agencies are organized as government-owned corporations. Like privately owned businesses, these corporations have a board of directors that hires a professional management team to oversee daily operations. These corporations charge

Dawn Tardif/Corbis

fees for their products and services, and the revenue goes back into the "business." Unlike private corporations, however, Congress supplies funds to cover any losses the public corporation may incur.

State and local governments also play a direct role in the economy. State governments provide colleges and universities, retirement plans, and statewide police protection. Local governments provide police and fire protection, rescue services, and schools. At the same time, all levels of government help develop and maintain roads, libraries, and parks.

Indirect Role of Government

The government plays an indirect role when it acts as an umpire to help the market economy operate smoothly and efficiently. One such case is the regulation of **public utilities**, municipal or investor-owned companies that offer products such as water, sewerage, and electric service to the public.

Because many public utilities have few competitors, consumers often want government supervision. For example, the federal government established regulatory control over the cable television industry in 1993 because it felt that some operators were charging too much. Without competition, utilities with exclusive rights in certain areas have little incentive to offer services at reasonable rates.

The government also plays an indirect role when it grants money to people in the form of Social Security checks, veterans' benefits, financial aid to college students, rent subsidies, and unemployment compensation. Such payments give the recipients of these funds a power they otherwise might not have—the power to "vote" by making their demands known in the market. This power influences the production of goods and services, which in turn affects the allocation of scarce resources.

Reading Check **Evaluating** Do you think one government role is more important than another? Why?

Economics ONLINE

Student Web Activity Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 3—Student Web Activities* for an activity on nonprofit organizations.

public utility company providing an essential service such as water or electricity to consumers

SECTION 3 Review

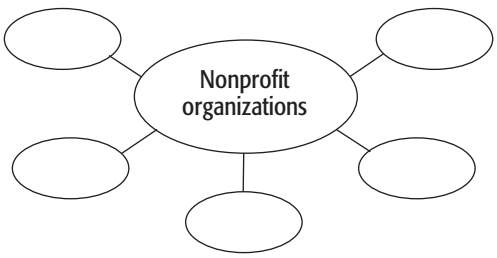
Vocabulary

1. **Explain** the significance of nonprofit organization, cooperative, co-op, credit union, labor union, collective bargaining, professional association, chamber of commerce, Better Business Bureau, and public utility.

Main Ideas

2. **Describe** the roles that federal, state, and local governments play in the economy.
3. **Identifying** Use a graphic organizer like the one below to identify the different types of nonprofit organizations.

Interactive Graphic Organizer



Critical Thinking

4. **The BIG Idea** Compare and contrast the purposes of the following nonprofits: American Red Cross, American Medical Association, and Teachers' Credit Union.
5. **Analyzing Visuals** Look at Figure 3.7 on page 80. Select one of the cooperatives and explain the benefits it offers its members.
6. **Inferring** What motivates individuals to join professional associations and unions?
7. **Drawing Conclusions** Explain why the government, rather than private firms, operates agencies such as the TVA and the FDIC.

Applying Economics

8. **Nonprofit Organizations** Identify a nonprofit organization in your community. Discuss with an official or volunteer of the organization how the loss of nonprofit status would affect its activities and services. Write a paragraph about your findings.

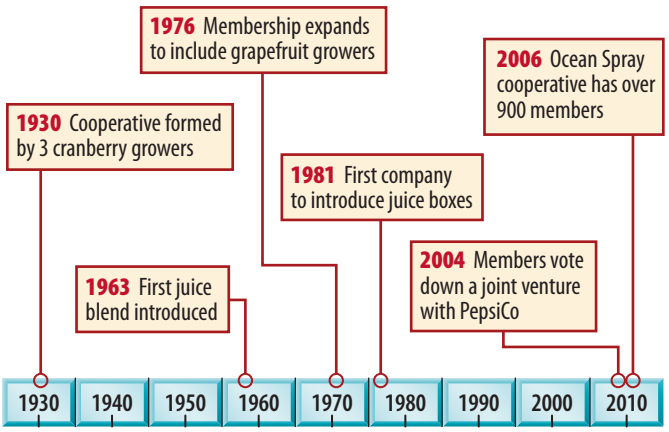
BusinessWeek NEWSCLIP

Running a cooperative doesn't make being in business easier. In fact, it may be especially difficult to secure high prices for members while remaining competitive in the market. Ocean Spray Cranberries Inc., one of the largest producer cooperatives in the United States, has made it work.

Ocean Spray's Creative Juices

Randy C. Papadellis has a corporate mandate that would make many CEOs blanch. . . . The chief executive officer of juice giant Ocean Spray Cranberries Inc. leads a cooperative that's owned by about 800 cranberry and grapefruit farmers. Papadellis has to buy all the fruit his farmers produce—about two-thirds of the world's cranberry crop—and buy it at the highest possible price. . . .

It's a dilemma that has sparked frenetic cranberry-fueled creativity. After spurring supermarkets to add juice aisles in the 1960s, Ocean Spray followed with hits including the first juice boxes, low-calorie cranberry drinks, and white cranberry juice. Now Craisins, the dried-fruit snack made from husks that used to be thrown away but are now reinfused with juice, have exploded in popularity. Ocean Spray is spinning out variations—chocolate-covered Craisins, anyone?—as fast as it can. The company's food product segment has doubled during the past two years, and total sales have grown 12%, to $1.1 billion. . . . Ocean Spray remains No. 1 in juices. . . .



Of course, past success isn't any guarantee of future results. . . . The cooperative is supposed to pay farmers the commodity price for fruit plus a dividend reflecting the profits of the Ocean Spray brand. But in 2000 overproduction sent the price of raw cranberries crashing from over $60 a barrel to under $20. . . . Papadellis quickly realized that the farmers needed to decide whether or not the cooperative still made sense. . . .

After weeks of arguing the pros and cons, and with a buyout offer on the table from Pepsi, the farmers opted for Papadellis' vision of a more focused Ocean Spray that would stay independent. . . . The plan not only improved the bottom line but also won back the trust of the farmers. . . .

—Reprinted from *BusinessWeek*

Examining the Newsclip

1. **Summarizing** What is the purpose of the Ocean Spray Cranberry Inc. cooperative?
2. **Analyzing** How does the organizational structure of the cooperative reflect member interests?

CHAPTER 3

Visual Summary

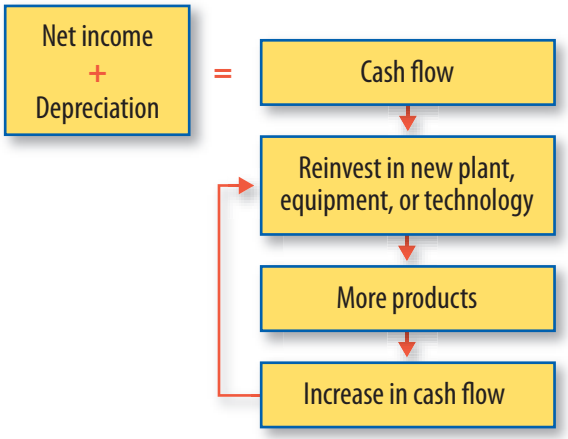
Study anywhere, anytime! Download quizzes and flash cards to your PDA from glencoe.com.

Business Organizations Three main forms of business organizations exist in the United States today.

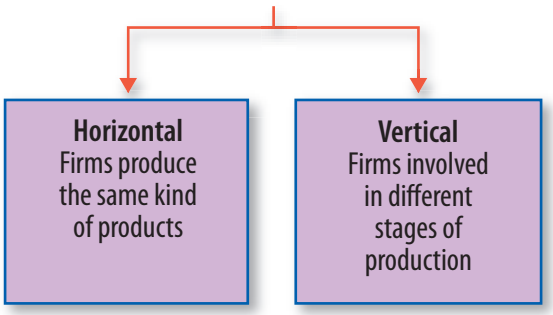
Sole proprietorships	Partnerships	Corporations
• Owned and run by a single owner • Easy to set up and operate with few or no requirements • Owner responsible for all operations but reaps all earnings • Owner has unlimited liability	• Two or more owners • Requires legal papers • Can attract different talents as partners • Relatively easy to raise capital • All partners are equally liable	• Owners purchase stock but do not run the company • Formal and legal arrangement • Easier to raise capital • Owners taxed twice • Limited liability

Growth A company can reinvest its profits or merge with another firm in order to grow.

REINVESTMENT



MERGERS



Nonprofit Organizations Some organizations work in a businesslike way to promote the interests of their members. Unlike businesses, these nonprofit organizations do not seek to earn a profit.

Community or civic organizations	Cooperatives
• Range from schools to churches and hospitals • Most are legally incorporated, with unlimited life and limited liability • Provide goods and services while trying to improve the quality of life for people	• Consumer cooperatives provide goods to their members at lower prices • Service cooperatives offer specific services to members • Producer cooperatives help members sell their products
Other organizations	**Government**
• Labor unions represent their members in employment matters • Professional associations seek to improve the skills, working conditions, and public perception of their members • Business associations support specific businesses or trade groups	• Has a direct role in the economy by providing some goods and services • Has an indirect role in the economy by acting as a regulator and a provider of benefits

CHAPTER 3

Assessment & Activities

Review Content Vocabulary

On a separate sheet of paper, classify each of the numbered terms below into the following categories. Some terms may apply to more than one category.

a. sole proprietorships
b. partnerships
c. corporations
d. nonprofit organizations

1. bond
2. stock
3. cooperative
4. dividend
5. unlimited liability
6. charter
7. labor union
8. professional association
9. limited partner
10. credit union
11. limited liability
12. limited life
13. merger
14. cash flow

Review Academic Vocabulary

Design a crossword puzzle using the terms below. Use a synonym or antonym (specify which) as your clue. For example, clues for "limited" could be "endless (ant.)" or "restricted (syn.)."

15. entity
16. comprise
17. internally
18. dominant
19. analyze
20. devoting

Review the Main Ideas

Section 1 *(pages 61–70)*

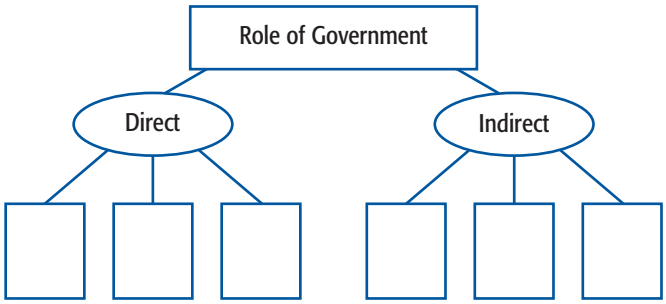
21. **Explain** why sole proprietorships are attractive for entrepreneurs wanting to start a new business.
22. **Identify** the strengths and weaknesses of a partnership.
23. **Describe** the difference between owning stocks and owning bonds.

Section 2 *(pages 72–77)*

24. **Describe** how a business obtains, and then disposes of, its cash flow.
25. **Discuss** the difference between a horizontal and a vertical merger.
26. **Explain** why a corporation might choose to become a conglomerate.

Section 3 *(pages 79–83)*

27. **Discuss** the difference between a nonprofit and other forms of business organizations.
28. **Describe** the purpose of a labor union.
29. **Identifying** Use a graphic organizer like the one below to identify examples of the direct and the indirect roles of government.



Critical Thinking

30. **The BIG Idea** If you were planning to open a business such as a sportswear store or lawn service, which form of business organization would you prefer—sole proprietorship, partnership, or corporation? Explain.

Economics ONLINE **Self-Check Quiz** Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 3—Self-Check Quizzes* to prepare for the chapter test.

31. **Drawing Conclusions** Do you think mergers are beneficial for the U.S. economy? Defend your response.

32. **Analyzing** Cite a case in your community where a cooperative would fulfill a definite economic need. Explain why you think so, and then describe what kind of cooperative you would set up.

33. **Comparing and Contrasting** What is the difference between the unlimited liability of proprietorships and partnerships, and the limited liability of corporations?

34. **Understanding Cause and Effect** What advantages might a multinational corporation bring to a host nation?

Math Practice

35. Examine the table that follows. Then answer the following questions.

Sole proprietorships, 1990–2002

	1990	1995	2000	2002
Business receipts	731	807	1,021	1,030
Business deductions	589	638	806	809
Net income				

a. What is the net income for each of the years listed? How did you find the answer?

b. In what year did sole proprietorships have the largest net income?

c. In what year did sole proprietorships have the largest net income as a percentage of business receipts? How did you find your answer?

Applying Economic Concepts

36. **Business Organizations** Return to your list from the Why It Matters activity on page 60. Now that you have learned about the different business forms, review the resources on your list and decide how you will organize your new business. Prepare an oral report and present your decision and rationale to the class.

Thinking Like an Economist

37. Identify two ways a firm's cash flow can be used. Explain why these uses are a trade-off, and explain the opportunity costs of these choices in terms of the firm's future growth.

Analyzing Visuals

38. Look at Figure 3.5 on page 75. Describe in your own words each type of merger. Then discuss the benefits of each.

Writing About Economics

39. **Expository Writing** Use the library or the Internet to research a conglomerate. Then write a paper describing where the company is headquartered, where its manufacturing plants are located, and where it sells its products. Also include reasons why the firm chose those particular locations.

Interpreting Cartoons

40. Look at the cartoon below. What message is the cartoonist trying to deliver? How does the cartoon relate to what you have learned about proprietorships and corporations?

John S. Pritchett

John S. Pritchett