Business Essentials: Concepts and Tools

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Course Description

This course provides an overview on the basic concepts and tools of business. Every functional aspect of business is covered. Topics covered are management, organization, human resource management, purchasing, production/operations, accounting, finance, marketing, quantitative methods, legal environment, information technology, business ethics, and international business.

Field of Study	Business Management
Level of Knowledge	Overview
Prerequisite	None
Advanced Preparation	None

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Chapter 1:

The Economic Basis of Business

Learning Objectives:

After studying this section you will be able to:

- Recognize attributes of economic systems and resource constraints.

Since the days of earliest civilization, man has been concerned with the problem of satisfying his unlimited wants with a limited supply of resources. This problem resulted in the development of the science of economics, which concerns itself with the distribution of scarce resources in a society with unlimited wants. These scarce resources are land, labor, capital, and entrepreneurship.

Land refers to all the natural resources available to man, including water, natural minerals, timber in forests, and the land itself. *Labor* refers to the manpower necessary to transform the resources into the products and services demanded by the society. Labor may involve either physical activity, or skills and talents possessed by individuals in society, or both. *Capital* refers to all equipment, tools, or other items used in the transformation of resources into usable products. Capital may refer to machinery, equipment, buildings, or the wage money used to hire labor. *Entrepreneurship* refers to the human skill of putting all of the other three resources together in such a way as to bring about an effective allocation of resources. The entrepreneur, therefore, is the individual who attempts to assemble an economic unit that specializes in developing and distributing these resources. Such an economic unit is called a business.

Alternative Economic Systems

The development of the business firm is dependent on the type of economic system a society adopts. Presently, three major economic systems are evident: (*a*) the capitalistic system, (*b*) the socialistic system, and (*c*) the communistic system. Regardless of the economic system adopted in any society, however, three basic economic questions must be answered: (1) What goods are to be produced? (2) How shall these goods be produced? (3) Who shall receive the goods and services that are produced? Capitalism, socialism and communism all answer these questions differently.

Under capitalism, the answers to the above questions are determined by individuals operating freely in the economy. Such a pure or free economy is called a "laissez-faire" economy, meaning that economic questions are resolved independently without guidance or interference by government.

Under socialism, the answers to these questions are largely determined by the state, since the state owns and operates the basic industries in the country. Such industries would include the industries of iron and steel, coal, railroads, and the utilities. Through the ownership of these industries, the socialistic economy attempts to influence the direction individuals move in their own economic decisions.

Under communism, all of the answers to these economic questions are determined by a central governing body, since, theoretically, all property is owned and operated by the masses for the benefit of the masses.

The American Enterprise System

The American enterprise system is generally thought of as a form of modified free enterprise. Under pure capitalism, individuals possess (*a*) the freedom to own property, (*b*) freedom of choice, (*c*) freedom to compete, (*d*) freedom to determine their own personal incentives and goals, (*e*) the opportunity to use the profit motive to their personal gain, and (*f*) complete freedom from government influence. The American economic system, for the most part, also grants these freedoms. There are, however, restrictions imposed on some of them, the most significant of which arise out of the unique relationship of government and business.

The most significant difference between pure capitalism and the American "modified" capitalism, is the role of government in the economy. Under pure capitalism, government has no role whatever in the resolving of economic problems. Under the American economic system, the government does have a role, but it is restricted by the American Constitution to one of protection and limited regulation. For example, the income tax tends to restrict the individual's ability to retain profit, since the more profit he makes, the higher the tax he must pay. Likewise, because some of our industries are regulated for the public welfare, individuals owning them do not have total freedom of operation. For the most part, however, the characteristics of pure capitalism are evidenced in the American enterprise system.

Business, by definition, involves all of the activities that play a part in bringing goods and services to the ultimate consumer of those goods. People engage in business because they see the opportunity to make a profit by marketing the product or service they produce. We can state, therefore, that business is primarily concerned with the satisfaction of human wants in return for a profit.

Profit can be viewed as the difference between the cost of producing or providing the product or service and the actual charge made to consumers of that product or service. If the goods and services provided by the businessman are, in fact, purchased by the consuming public, the businessman will profit. If, on the other hand, the entrepreneur is not successful at marketing his products, he will suffer a loss. This element of risk, or uncertainty of profit, is an inherent obligation that the entrepreneur must accept in a capitalistic economy.

Business enterprises can be classified in various ways. They can be classified by function and/or by industry. First, businesses can be of a type called *processing* or *extractive* enterprises. Examples would be agricultural companies and mining companies. Second, business firms can be *manufacturing* companies, such as automobile and appliance makers. *Facilitating* enterprises, such as finance companies, transportation companies, and communication enterprises are a third type. A fourth type, the *marketing* enterprise, is typified by business firms engaged in the retail and wholesale trade.

Contemporary Business

The continuing quest for more profits, and the desire and need to satisfy the ever-changing demands of society require that business firms continually change themselves. Some of the important changes that business has witnessed are: (*a*) the use of electronic data processing in an unprecedented scale, (*b*) the continued use and refinement of automation in production of goods, (*c*) the shift in emphasis from a production-oriented economy to a distribution-oriented economy, (*d*) the continued shift from an industrial economy to a service economy, and (*e*) the increasing use of mathematics and simulation models in attempts to forecast and anticipate changes in consumer demand.

American business has been the most successful capitalistic endeavor ever attempted by man. Its success in producing and distributing goods is evidenced by the high standard of living enjoyed by most Americans. Americans today enjoy the highest gross national product, the highest wage level, the highest productivity per man-hour, and the most sophisticated business leadership talents in the world. its material success has not been without its share of problems, however. Business growth has created problems of overabundance of some goods. The increasing size of selected business units has caused concern in society about the concentration of economic power in the hands of a few. Government has grown in size and power, partially because of the increasing need to supervise business activity and to protect small business from unfair competitive practices by others. The fact remains, however, that America has seen its business community resolve the problem of providing the basic needs of living for a vast majority of its citizens.

Chapter 1 Review Questions

1. The manpower necessary to transform resources into products and services is:

   A. Land

   B. Labor

   C. Capital

   D. Entrepreneurship

2. Under American capitalism as opposed to pure capitalism the most significant difference is:

   A. The freedom to own property

   B. Freedom of choice

   C. Role of government in the economy

   D. Freedom to compete

Chapter 2:

The Legal Structure of Business

Learning Objectives:

After studying this section you will be able to:

- Recognize the different types of business structures

American business exists in a "modified laissez-faire" economic climate. This means, in effect, that most business transactions are conducted by economic units that are privately, not publicly, owned. This distinction is part of the unique quality of the American economy. However, because the economic units in America are privately owned, it is necessary to examine the legal structure of a business and to determine how and why a particular type of business organization was chosen for a particular enterprise.

The entrepreneur who begins a business must consider certain factors in deciding on the type of business organization he wishes to have. These factors must be considered because of their influence on his personal control of the business. For example, considerations regarding (a) the ease of organization, (b) the ease with which capital can be raised, (c) the liability for business debts, (d) the question of managerial control, and (e) the possibilities for expansion are all such factors. He must also consider external factors that may influence his present and/or future welfare as a businessman. These include such factors as (a) the degree of governmental control, (b) the taxes, (c) the geographical area of operations, (d) the ability to change the nature of the operations, and (e) the ease of transferring ownership. The answers the entrepreneur reaches to these questions will influence the ultimate form of business organization that is adopted. While there are many ways a business unit can be structured, most businesses in America today are structured as (a) sole proprietorships, (b) partnerships, (c) corporations, (d) limited liability companies, and (d) franchises. Of these, the sole proprietorship is the most common.

Sole Proprietorships

The sole proprietorship dates back to the earliest economic system. It is characterized by a single owner, or, as its name implies, a sole proprietor. It is easily the most common form of business ownership in the country today. Being the most common, however, does not mean that it is the most important. In terms of sales volume, the sole proprietorship is far overshadowed by the corporation.

Advantages of the Sole Proprietorship. Several factors help account for the popularity of sole proprietorships. They are the easiest of all forms of business ownership to organize and are the least complex. Because they are essentially one-man operations, the owner-manager has a great deal of managerial freedom, and this helps provide him with a maximum of personal incentive. The proprietor reaps all of the profits from the business, although these profits are generally lower than if the business were a corporation. The corporation is a taxpaying entity, while the sole proprietorship is not. It is also relatively easy for the sole proprietor to enjoy a favorable credit rating, since, by his position as owner, he is ultimately responsible for all business debts and obligations. Should the sole proprietor decide to quit the business, he can do so with a minimum of legal difficulty.

Disadvantages. The sole proprietorship is not without its disadvantages, however. The sole proprietor, as was pointed out, is ultimately responsible for all of the obligations of the business. This feature, known as unlimited liability, is perhaps the greatest single drawback to this form of business ownership. Also, the inability to offer possible ownership or high managerial position to employees tends to diminish effective employee incentive. The sole proprietor is usually the sole manager, and he is forced to make the decisions in all facets of the business. As a result, sole proprietorships usually lack certain specialized managerial talents.

As the sole proprietorship grows, the demand for additional capital increases. The sole proprietorship, while enjoying a good credit rating, is likely to find its credit resources exhausted quickly and thus see the growth of the business stunted. For this reason, most sole proprietorships tend to remain small.

Finally, there is no assurance of any long-range continuity of existence of the sole proprietorship. If the owner dies or becomes legally irresponsible, the business comes to an end. This inability to assure continuous existence also hampers the growth and capital-raising capabilities of the sole proprietorship.

Still, sole proprietorships have continued to find favor with many businessmen. The service industries of today, requiring low capitalization, personalized service, and few managerial talents have found this form of business ownership particularly attractive.

Partnerships

A second form of business ownership, and one that is probably as old as the sole proprietorship, is the partnership. The partnership is a business venture that has been voluntarily entered into by two or more persons. The partnership agreement is usually written (although it need not be) and is referred to as the Partnership Agreement of the Articles of Co-partnership. The Articles of Co-partnership contain such provisions as: (*a*) the name of the business; (*b*) the location of the business; (*c*) the length of life of the partnership agreement; (*d*) the names of the partners, their investment, and the way in which profits and losses are to be divided among them; (*e*) any provisions for salaries or withdrawals of investment by the partners; and (*f*) the procedures to be followed for dissolution of the partnership.

Advantages of Partnerships. The partnership shares many of the advantages of the proprietorship. As a form of business organization, partnerships are easy to organize, are relatively free of governmental supervision and regulation, and are easy to dissolve. Unlike sole proprietorships, however, partnerships have the following advantages: (*a*) there are larger amounts of capital to draw from, since there is more than one owner contributing an investment; (*b*) more specialized management is available, since each partner presumably will wish to be active in the firm and will bring individual talents to it; (*c*) because the possibility of achieving eventual partnership status exists, the partnership retains the capability of maintaining high personal incentive for all employees; (*d*) the partnership possesses a definite legal status-if the partnership agreement was put in writing; and (*e*) the partnership has an exceptionally high credit rating, due primarily to the legal liability of all of the partners.

Disadvantages. the partnership, however, has certain distinct disadvantages. Foremost, of course, is the unlimited liability to which all general partners are subjected. Second, the partnership has a very uncertain life, since the death or withdrawal of any one partner brings the partnership to an end. Third, the initial investment of the partners sometimes becomes "frozen" in the business-that is, it becomes a permanent investment. Should a partner need to withdraw his investment, it may require terminating the partnership.

Finally, and perhaps more importantly, are the personal conflicts and distrusts that may develop among the partners. Each partner can make all other partners liable for his actions, a factor that may create dissension among the partners. Then too, the successful execution of the partnership agreement requires that each partner do his share in the business, and proper assurance of this becomes difficult with the addition of new partners.

Some of the difficulties encountered with the traditional partnership can be overcome, however, with the use of several variations on the usual partnership arrangement. For example, one partner may elect to be a "limited" partner, instead of a general partner, in which case his potential liability for business debts extends only to the amount of his investment. He is not permitted to take part in the active management of the business. Other types of partners are: (*a*) silent partners, (*b*) secret partners, (*c*) dormant or sleeping partners, and (*d*) nominal partners. Each of these has restrictions as to his active participation in the business, and in some instances, is restricted in the obligations he has to the business.

Finally, partners may be designated as "senior" or "junior" partners. As may be anticipated, the senior partner usually has the larger investment in the firm, has the major say in operational questions, and receives a larger share of the profits.

It should be noted that partnerships are not a very popular form of business ownership. In fact, over the past 10 years the number of such businesses has declined. The reasons for this decline are probably attributable to the reasons mentioned above as disadvantages of the partnership form.

Limited partnership

Limited partnership has one or more partners, some with limited liability up to their investment if business fails. *Example:* real estate. It has the following features.

- General partner manages the business.
- Limited partners not involved in daily activities.
- Limited partners receive return in the form of income and capital gains.
- Limited partners often receive tax benefits.

The Corporation

The third major form of business organization is the corporation. The corporation was designed to overcome one primary difficulty with the sole proprietorship and the partnership, namely, the limited, uncertain duration of their existence. Over the years, however, the attractiveness of many of the other features of the corporation sparked its continued growth, and today the corporation accounts for most of the business activity transacted.

Today, we define a corporation in much the same way Justice Marshall did when he described the corporation as "an artificial being," "existing only in law." In other words, the corporation is a "legal entity," possessing only those powers specifically granted it in its charter.

The corporation is made up of individuals (usually three or more) who invest money in a business enterprise. They then receive certificates, or shares of stock in the company. These "shareholders" are entitled to vote at company meetings, receive dividends on their investment, and transact other business at the annual meeting of the stockholders. The stockholders elect a "board of directors" that is responsible for setting broad policies of the company and for selecting corporate officers to manage and operate the business.

Advantages of the Corporate Form. The corporate organizational form offers several distinct advantages to its owners: (*a*) the perpetual life of the business, brought about primarily by the ease with which ownership can be transferred; (*b*) the limited liability of the owners-their potential loss being limited to the amount of their investment; (*c*) the practice of employing specialists in managerial capacities, which extends managerial talents beyond those of a few partners; (*d*) the ease of expansion, due primarily to the easy access to the capital markets -to raise more capital, the corporation has merely to issue more stock; and (*e*) the fact that the corporation is a legal entity enables it to sue and be sued and to possess most of the rights and obligations of a real person.

Disadvantages. Again, the corporation is not without its drawbacks. Since a corporation must be chartered by a state government or the federal government, the costs of organizing can be high and the process can be difficult. Even after the corporation receives charter approval, it must pay a franchise fee and/or an organization fee. It then must file periodic reports on its activities to the government. This filing of reports removes much of the secrecy of operations that the partnership and sole proprietorship enjoy. The corporation is also required to pay income taxes on its income as an entity. The stockholders *also* have to pay income taxes on any dividends received. This is sometimes referred to as "double taxation." Finally, corporate managers may sometimes lack motivation because of the impersonal relationship that exists between the stockholders and the appointed management.

The Corporate Charter. An indication of the complexity of applying for corporate status as a business can be seen in the corporate charter. This document describes the purposes and nature of the corporation. Among other things, it indicates: (*a*) the corporate title, (*b*) the name of the state granting the charter, (*c*) a descriptive statement of the purposes of the corporation, (*d*) names and the number of directors, (*e*) location of the corporation's general office, and (*f*) the amount of stock the corporation has been authorized to issue. Further laws and regulations are set forth in the corporate bylaws.

Board of Directors. As indicated, the stockholders of the firm elect a board of directors which is responsible for the overall policies of the company. One member is elected chairman, and his is a full-time position within the company. Other board members may also be full-time company executives, but it is customary to have a number of directors from outside the firm. The board meets only when requested to do so by the chairman, or as often as the charter may stipulate.

The board of directors appoints the president of the company, and he is charged with responsibility for the operations of the company. He may be granted the authority to select the vice presidents and other officers. As required by law, the corporate management sends an annual report to all stockholders indicating the year's progress and achievements. Many firms also send quarterly reports. The annual report is usually sent just prior to the annual meeting of the stockholders, so that they may examine it and question the management at the meeting if they so desire.

Types of Corporations. Just as partnerships may take different forms in order to achieve different ends, so too may the corporation take different forms. Corporations may be classified as follows. (1) Either *public* or *private* . Public corporations are those operated by a governmental body; for example, some towns incorporate. Private corporations are those owned by private stockholders, as indicated above. (2) Either *profit* or *not for profit.* (Some charitable organizations incorporate to take advantage of the limited liability feature.) (3) Either *stock-issuing* or *nonstock.* (4) Either *open* or *closed*. Open corporations have stock on the open market available for purchase by anyone who wishes to buy in. Closed corporations are similar to private companies in that they have only a few stockholders, leaving the general public no opportunity to participate in ownership.

Finally, corporations are usually classified as either *domestic, foreign,* or *alien,* depending on the state or country in which they incorporated and the state or country in which they operate. Companies are classified as domestic corporations by the state in which they were incorporated. In all other states, they are classified as foreign corporations. Companies that were chartered in a foreign nation are considered alien corporations in the United States.

Corporations are governed by a distinct set of state or federal laws and come in two forms: a state *C Corporation* (Discussed above) or *federal Subchapter S.*

Subchapter S Corporation

A Subchapter S Corporation is a form of corporation whose stockholders are taxed as partners. However, unlike a partnership, shareholders cannot receive allocations disproportionate to their interests. To qualify as an S corporation, a corporation must:

1. A corporation cannot have more than seventy-five shareholders.
2. It cannot have any nonresident foreigners as shareholders.
3. It cannot have more than one class of stock.
4. It must properly elect Subchapter S status.

The S corporation can distribute its income directly to shareholders and avoid the corporate income tax while enjoying the other advantages of the corporate form. *Note*: Not all states recognize Subchapter S corporations.

Limited-Liability Company

Limited Liability Companies (LLCs) are a relatively recent development. Most states permit the establishment of LLCs. LLCs are typically not permitted to carry on certain service businesses (e.g., law, medicine, or accounting). An LLC provides limited personal liability, as a corporation does. Owners, who are called members, can be other corporations. The members run the company unless they hire an outside management group. The LLC can choose whether to be taxed as a regular corporation or pass through to members. Profits and losses can be split among members any way they choose. *Note*: The LLC rules vary by state.

The Franchise

In recent years, the franchise has joined the sole proprietorship, the partnership, and the corporation as a popular form of business organization. The franchise combines elements of the sole proprietorship with those of a corporation. Specifically, a franchise is an operating agreement in which one party (the franchisee) agrees to operate a business developed by another (the franchisor.) The franchisee agrees to pay the franchisor a fee for the use of the franchisor's name.

Advantages of the Franchise. Typically, franchises are sole proprietorships and thus have all the advantages of sole proprietors. Also, however, franchisors often provide operating assistance, showing the franchisee how to keep records, how to operate most efficiently, and even provide help in buying new material. Most importantly, the franchisee is able to use the name of the franchisor. Think of the value in being able to call your hamburger outlet "McDonald's," and to use the 'golden arch' symbol! Often, the name of the franchisor is enough to guarantee success!

Disadvantages. Sometimes the national image of the franchisor is not as good as it might be. In this instance, the franchisee can be hurt by the association. Also, franchises are expensive. Often the fee that must be paid to the franchisor is a percent of sales. If the franchisee does not keep careful control over costs, he may find that all of his profits are being paid to the franchisor. Finally, the franchisee loses some independence under a typical franchise agreement. Advertising may be designed in a special way, the product being sold must conform to what other franchises are selling, etc. For these reasons, franchises have become popular in some products and services but not in others.

Other Types of Organizations

Several variations exist on these more common forms of business organizations. The *business trust*, for example, is similar to both the corporation and the partnership, offering the advantages of the former without the disadvantages of the latter. This form of business operates exactly like a corporation, except that all property is deeded to a board of trustees to manage. Depending on the terms of the trusteeship, the participating members of the Massachusetts Trust, as it is also known, enjoy limited-liability protection.

The *joint venture* is a short-term undertaking by two or more parties to achieve a particular goal. When the goal is achieved, the venture is dissolved. Such an organization is similar to a short-term partnership, since all parties have unlimited liability. Occasionally, a joint venture is organized for the purpose of selling securities to the public. Such a venture is usually referred to as a *syndicate*, and while still a joint venture, the syndicate differs only in that it enjoys limited-liability protection.

A form of organization not commonly found in the United States is the *cooperative*. A cooperative is a form of corporation that is designed to assist the members in achieving a particular goal. For example, in agriculture, a cooperative may be organized to distribute the produce, thereby eliminating the middleman. Profits thus earned are returned to the members. The cooperative can be called, therefore, an association of members united for a common purpose; in the above case, the purpose was to increase the profits earned by the farmers who belonged to the cooperative.

Chapter 2 Review Questions

1. The greatest single drawback to a sole proprietorship is:

   A. Managerial freedom

   B. It is a tax paying entity

   C. Reaps all the profit

   D. It has unlimited liability

2. The disadvantage of a corporation may include:

   A. Perpetual life of the business

   B. Stockholders have to pay income taxes on dividends received

   C. Limited liability of the owners

   D. Ability to sue or be sued

Chapter 3:

Management and Organization

Learning Objectives:

After studying this section you will be able to:

- Recognize the concepts and functions of management.

In order for a business firm to operate in an economy, certain objectives, policies, and procedures must be established for the various departments in the firm and for the firm as a whole. The establishment of these policies, goals, and objectives is the responsibility of the business firm's management.

Management can be defined as the process by which the factors of production-men, materials, machines, money, and methods-are combined to achieve the various goals of the business firm.

The management process of combining the factors of production usually encompasses four or five distinct functions: (*a*) planning, (*b*) organizing, (*c*) actuating, and (*d*) controlling. Sometimes the function of actuating is subdivided into the functions of (*a*) staffing and (*b*) directing, thus resulting in five functions of management.

Management occurs at all three levels of the business enterprise; that is, it is performed at the top, middle, and operating or supervisory management levels. While each of the functions of management is performed at all three levels of managerial control, some of the functions are concentrated at particular levels of management.

Top management comprises the corporate board of directors, the board chairman, the president, the vice presidents, and any executive committees that may have been formed to help establish policy. Most of the efforts of top management are concentrated on the function of *planning.* The planning function determines what shall be done, how it shall be done, why it shall be done, and by whom. Planning procedures, in turn, are determined by the objectives of the firm.

The objectives of the firm are also determined by top management. These objectives may be either general objectives, such as determining the types of products the company will concentrate on producing, or the objectives may be specific. Setting a goal of a certain profitability or return on investment would be an example of a specific goal.

Middle management consists of the department heads, other general managers, and division heads. This group usually is not responsible for establishing overall company policy and goals, but is, to a large extent, the group that transforms company goals into operational policies.

Top management and middle management are jointly responsible for establishing operational policies. These policies may involve such things as the pricing policy for product lines, the financial policy of the firm, and various production policies. These policies are the guidelines for other managerial and operational decisions within the firm.

Organizing involves the utilization of men, materials, money, and machines in such a manner as to efficiently achieve the desired results. The organization may stress the methods of operation, or it may emphasize the organizational structure of the firm, stressing the managerial structure and hierarchy of command within the firm.

The *actuating* function concerns the blending together of all of the distinct departments and operations in the business enterprise. Coordination is vital, for example, between the sales department and the production department, so that one is not selling goods that cannot be delivered when promised, and the other is not producing goods that cannot be sold.

The *control* function concerns the evaluation of all of the activities of the firm and the comparison of these activities with the desired objectives of the firm. The purpose, of course, is to locate sources of inefficiency in operations. It is worth noting that this final step in the managerial structure is directly related to the first step, since many future decisions, plans, and changes in organization will depend on the results obtained from the controlling of previous tasks.

Internal Organization

The internal organization of a business firm is contingent on several factors. The size of the business firm plays an important part in determining the organizational structure of that business. The optimal internal organization for a sole proprietorship, for example, may not work out well for a large corporation. Also, the dependency on a particular product or product line may cause the adoption of an organizational form that, for one reason or another, is not suited to the production of that product. Finally, the philosophy of management is important. Some managerial persons are strict advocates of a strong centralized operation; others favor a more decentralized approach. The choice of the two will greatly affect the type of organization the firm adopts.

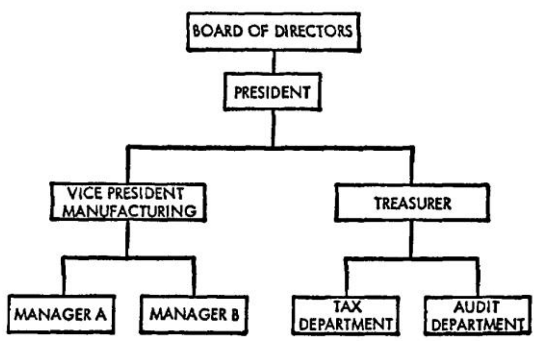
There are three major types of formal organizational structures; (*a*) the line organization, (*b*) the functional organization, and (*c*) the line-and-staff organization.

Line Organization. The line organization is characterized by a vertical chain of command, running from a supervisor to his subordinates. The flow of authority and responsibility is also vertical. The oldest of all the forms of organization, the line organization derives its basic structure from the military. This form of organization has several important strengths. It is simple to establish and clearly identifies sources of authority and responsibility. Because authority and responsibility are clearly identified, discipline is easily promoted. Decisions are made quickly and efficiently, if not always accurately. Workers know definitely to whom they report, and thus shifting of responsibility is avoided.

There are, however, several drawbacks to the line organization. The most serious drawback is the heavy burden of responsibility it places on the chief operating officer. Also, it creates little incentive to make decisions at lower levels and limits opportunities for promotion. Coordination and teamwork are restricted, since frequently divisions rival one another for the favor of the president or chief operating officer.

Because of these disadvantages, the line organization has not been popular in large organizations. It is, however, the predominant form of organization in small and medium-sized businesses.

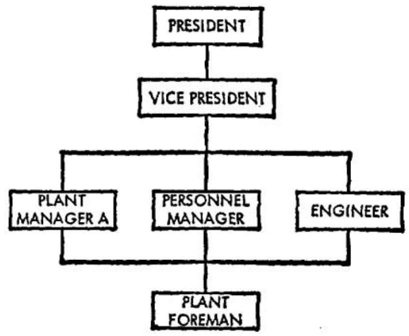
Line Organization



Functional Organization: Around the turn of the century, Frederick W. Taylor developed a system of internal organization that divided authority within the business by function, putting a division under several supervisors, each specializing in one particular function. Each of these supervisors also had jurisdiction over his particular function in each of the other divisions. Taylor was deeply concerned with efficiency, and he saw this new system as encompassing the use of specialists and experts in positions of authority within the firm, thus maximizing the efficiency of the plant. Such a system came to be known as functional organization, and though it is rarely seen today in its pure form, it was instrumental in molding the presently popular form of organization, the line-and-staff organization.

Functional organization never achieved popularity because of several inherent disadvantages. The most serious drawback was the confusion that resulted from a subordinate reporting to two or more supervisors. The tendency for duplicity in commands as well as the tendency for "buck-passing" are severe drawbacks to the functional organization.

Functional Organization



Line-and-Staff Organization. The line-and-staff organization is an attempt to utilize the strengths of the line organization in conjunction with the strengths of the functional organization. The militarily like structure of the line organization is preserved, thereby assuring the advantages of the line organization. However, the line managers are supplemented with staff assistants-functional specialists who possess no formal line authority but whose expertise is available to the line official for advice in decision making. This accomplishes two additional advantages to those previously indicated for the line organization: (*a*) it allows for a division of labor, and (*b*) it reduces the potentiality for error in decision making by executives lacking in technical knowledge.

There are several disadvantages to the line-and-staff organization, however. Executive overhead may be greatly increased by the addition of numerous staff personnel. Also, a strong staff official may end up exercising *de facto* line authority if his line superior is not careful.

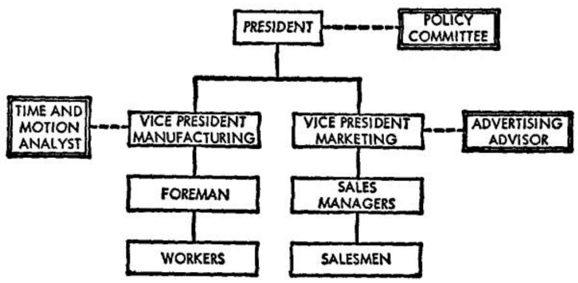
Despite these limitations, the advantages favoring the line-and-staff organization have caused it to be the most widely accepted internal organization among large companies.

It becomes apparent from the aforementioned organizational patterns that one of the prime concerns regarding a formal organization is the disposition of the problems of authority and responsibility. *Authority* refers to the power to make decisions. *Responsibility* refers to the accountability for results that occur because of decisions that have been made. The concepts of responsibility and authority should never be divided; indeed, one of the major shortcomings of the functional type of organizational structure was its inability to pinpoint responsibility for decisions.

Sometimes authority and responsibility for various decisions must be delegated. *Delegation* refers to the arbitrary assignment of the power of decision making to another. The degree to which an executive can delegate authority and responsibility and still maintain the proper degree of management over operations determines the *span of control* for the executive. In some companies, the span of control is, of necessity, much larger than in other companies.

Organization charts and manuals serve to show the structure of a company and to reveal the span of control over operations exercised by each person. The manuals contain the general policies and regulations of the company; the charts show the formal structure and division of authority and responsibility within the firm.

Line-and-Staff Organization



Chapter 3 Review Questions

1. The function concerned with the evaluation of all the activities of the firm and the comparison of those activities is the:

A. Organizing function

B. Actuating function

C. Controlling function

D. Planning function

2. The disadvantages of the line organization can include:

A. It is simple to establish

B. Decisions are made quickly and efficiently

C. Workers know definitely to whom they report

D. The burden of responsibility that it places on the Chief Operating Officer

Chapter 4:

Human Relations

Learning Objectives:

After studying this section you will be able to:

- Differentiate among the types of psychological needs and types of leadership.

Human relations involve the activities and relationships resulting from the interaction of two or more people. In a business situation, human relations concerns the reason for the way people act and for the degree of motivation they possess. It concerns, in short, all of those activities that result because of the interactions of people. It can be seen, therefore, that a knowledge and understanding of human relations is essential for a manager if he is to successfully organize the activities of people in order to attain a company's goals and objectives.

The study of human relations was not always of paramount concern to the business executive. At one time, workers were considered in the same vein as machines, merely another "factor of production." Companies were noted for the paternalistic attitude with which they treated their employees. Workers were housed, clothed, and fed by their employer -and, in turn, were expected to give absolute loyalty and service to the company. This philosophy soon gave way to a more enlightened one-one which respected the rights and feelings of the individual worker, thereby establishing the principle of human relations.

All corporations have goals and objectives. So, too, do individuals. Often, the goals and objectives of the corporation and those of the individual are complementary; that is, they can be satisfied simultaneously. For example, the worker may desire to purchase certain material goods. The company wishes to produce goods to sell to consumers. By hiring the worker and paying him a wage, the corporation achieves its objectives as a producer, and the worker at the same time satisfies his needs as a consumer. However, such examples of physical need satisfaction do not tell the whole story. Individuals also have psychological needs which need satisfying, and sometimes these needs can conflict with the satisfying of the physical needs. It is in the resolving of these psychological needs that human relations plays its most important role in today's business firm.

Types of Psychological Needs

Different people have different psychological needs, just as they have different physical needs. However, in a corporate enterprise, certain needs appear to recur more frequently than others. Among the most important are: (*a*) status, (*b*) prestige, and (*c*) esteem.

Status can be defined as the relative position a person has achieved within the business enterprise. Status can be of two types; it may be either achieved or ascribed. Achieved status is status earned because of some personal accomplishment. A college graduate moving into a junior executive position is considered to have achieved status; his position came to him because he possessed a college degree. When people advance within a business enterprise solely because of their past performance, they can be considered to have "achieved" status.

On the other hand, status may also be ascribed. Ascribed status is the attaining of a position on the basis of factors *other than* accomplishment. For example, if the son of the president of the firm suddenly emerges as a vice president, even though he has just joined the firm, he can be said to possess "ascribed status." Ascribed status is, as previously stated, status that befalls a person as a result of factors other than accomplishment. It may be birth, race, sex, or any other non-earned factor.

Prestige is the recognition a person receives as a result of his status. Thus, when a person achieves a position of higher status, he usually gains in prestige, since one usually follows the other. Prestige can be recognized in several different ways. For example, the salary level of a worker may be an indication of the prestige and status of a worker. Similarly, the level within the organization or the type of work may be indications of the prestige of the worker. Each of these factors helps determine the prestige of the status.

Esteem is the regard a person is held in by his peers and subordinates or superiors. Esteem, unlike status, is usually the result of accomplished activity. A worker may occupy a position with little status or prestige, but still be held in high esteem by his co-workers because he does his work well. Conversely, a person can occupy a position of status and prestige but not command the esteem of others around him.

In today's business world, the problem of identifying status is indeed a difficult one. Each large corporation, for example, has numerous departments operating at approximately the same level of authority within the corporate structure. The question becomes, "How do you determine who has status and who doesn't?" With the checks and balances, and crossed lines of authority that exist in the corporation, the issue becomes highly complex. The result of all of this has been the development of various "status symbols" for use by those who feel they need them to publicize their position. Status symbols can take many different forms. Carpeting on the floor, having a private office near the top floor, possessing certain types of office equipment, or even having dinner with the boss can be status symbols.

Much of the emphasis on status symbols is created by the company itself. Faced with the problem of rewarding good workers with jobs that satisfy psychological needs, companies developed various "symbols" to dente some sort of prestige factor for the favored worker. Although fine in theory, some of the problems created are greater than the ones solved. For example, companies bestowing status symbols on one worker and not on others run the risk of (*a*) disenchantment on the part of the other workers, or (*b*) a sudden attitude change on the part of the favored worker that results in his being more of a problem and less of a contributor than he was before the bestowing of the symbols.

Management of Human Relations

To develop a favorable work climate, one that considers the many physical and psychological needs of the workers, it is important that the management of the firm possess the proper "mix" of skills in managing human relations. For example, business executives need to possess two types of talents, one conceptual and the other technical. The higher up the ladder of managerial succession one goes, the more he will need conceptual talents and the less he will need technical talents.

It is often overlooked, but important to recognize, that the human relations problem exists at all levels of management, and is, therefore, demanding of a knowledge of human relations by executives at all levels. Thus, conceptual skills (that is, the ability to perceive an abstract problem in its entirety, and to develop alternative courses of action based on this conception) need to be reinforced by human skills (the ability to understand people, their motives, their needs, and their interrelationships with one another). Only in this way can a manager truly maximize the productivity of the company and the output and satisfaction of the workers.

The Role of Leadership in Human Relations

Leadership can be defined as the ability to direct the activities of others toward the solving of a mutual problem or the accomplishment of a mutual goal. There are three main types of leadership: (*a*) authoritative, (*b*) participatory, and (*c*) indirect.

Authoritative leadership is a centralized leadership. One person gives the order and expects it to be obeyed without question. There is no room for individual judgment, discussion of alternatives, or criticism. Authoritative leadership is most predominant in family-owned businesses, or closely held companies.

Participative leadership is leadership by delegation. Much of the authority for decision making is delegated to subordinates, thereby sharing the leadership role. Although this type of leadership satisfies the psychological needs of many workers, it can also lead to problems. Productivity can decline if there is no one individual to act as "leader" and encourage the others to excel at their work.

Indirect leadership, or "free-rein" leadership, is leadership by group; that is, it involves the delegation of authority for leadership to groups within the company. The technique of "sensitivity analysis" is to some extent founded on this concept. Sensitivity analysis itself revolves around small group meetings where a high level of individual participation and involvement takes place. The goal of sensitivity training is to increase a person's awareness and knowledge about personal and interpersonal factors that influence the behavior of individuals. The concept of indirect leadership becomes apparent in sensitivity training in the small group meetings, where problems are placed before the group, and leadership is assumed by one or more individuals in the group.

Organizations and Human Relations

Within each large company there exists at least two distinct types of organizations. One is the formal organization, shown by the organization chart of the business firm. Within the formal organization, status and prestige are conferred by position in the official structure. However, also found in large corporations are informal organizations developed by the workers to help them satisfy certain of their own goals. These goals are partly social, partly psychological. Within the informal organization, esteem may be the most significant characteristic. These informal groups can be both a help and a hindrance to the corporation. If they are recognized, treated with respect, and acknowledged, they can be helpful in furthering communication and goodwill within the company. On the other hand, if they are frowned on by the management, they can be highly disruptive to the organization. The informal group is perhaps best known for the "grapevine," a communication channel that is highly successful at transmitting information to people at all levels of the company. While the grapevine tends to be erratic insofar as its accuracy of information is concerned, some companies have found it useful to rely on it for conveying communications that need to be passed on to lower echelons.

The Healthy Work Climate

It can be seen, therefore, that the successful organization is one that recognizes the needs of employees and attempts to meet their needs. The informal organization and the role of status, esteem, and prestige all play vital parts in determining the degree of success in handling corporate human relations.

Chapter 4 Review Questions

1. The psychological factor that can be defined as the relative position a person has earned within the business only on past performance is:

A. Achieved status

B. Ascribed status

C. Prestige

D. Esteem

2. Leadership by delegation is:

A. Authoritative leadership

B. Participative leadership

C. Indirect leadership

D. Free-rein leadership

Chapter 5:

Labor Relations

Learning Objectives:

After studying this section you will be able to:

- Identify labor goals, labor-management problems, and key labor legislation.

Labor, as was indicated earlier, is one of the primary factors of production. In a capitalistic society, workers strive to achieve personal goals as though they were entrepreneurs. It matters not that they are hired for a wage to work for someone else; what matters is that the worker can choose his employer and can bargain with him for the means to achieve his goals. What are these individual goals? Basically, they are; (1) higher wages and a higher standard of living, (2) greater job security, (3) a sense of dignity in work, and (4) recognition by the employer of the importance and worth of the individual.

In the early days of America's industrialization, laborers found that it was impossible for one man to bargain effectively with his employer. Conditions were such that laborers had to take the terms and conditions offered them, or go without work. The laborer was effectively prevented from reaching his goals. It was this overbearing power of business to dictate work conditions that led to the establishment of labor unions.

History of the Labor Movement

When it became obvious to workers that they were not going to achieve their goals by individual bargaining with management, they began to form labor unions. Such unions were formed secretly at first, because of the fear of being put on a blacklist by management.

The first of the major labor movements in the United States was spearheaded by the Knights of labor. Begun in 1869, this organization, representing basically a political movement, aimed at changing the capitalistic structure of the American economy. It served an important role in the labor movement, however, in fighting for the eight-hour day and the abolition of child labor. It reached its height in 1886, with a membership of over 700,000. As it grew in size, it began to divide over basic issues of purpose. Eventually, several craft unions split off from the Knights of Labor. (Craft Unions were organizations whose memberships were composed of skilled craftsmen, and whose craft was learned through vigorous apprenticeship training. In contrast, industrial unions were organizations whose memberships were made up primarily of unskilled factory workers.)

In the ensuing years, the Knights declined in popularity and gradually disappeared from the American labor scene.

In 1881, the several craft unions that left the Knights of Labor formed a new union. In 1886, that new union became known as the American Federation of Labor. As its leader, the AFL chose Samuel Gompers, who was president until 1924, when he was succeeded by William Green. George Meany became president of the AFL in 1952. The AFL grew to become the dominant force in the labor scene. However, industrial workers soon revolted against the policies of the AFL. They began to organize on an industry basis, and were expelled from the AFL in 1937. They then formed their own union, the Congress of Industrial Organization (CIO). The first president was John L. Lewis, followed by Philip Murray in 1940, who was in turn succeeded by Walter Reuther in 1952.

The structure of the AFL-CIO is similar in some ways to the structure of a corporation. The main body of the structure is composed of a large number of local unions. These, in turn, constitute the various state and national unions. From these come the national and international officers, who serve in much the same capacity as the board of directors of a corporation. The annual convention of labor unions periodically elects these officers.

The labor movement grew rapidly in popularity for several reasons. Workers were discovering that only by joining together could they exercise enough strength to obtain their individual goals. Also, they began to realize that goals they had previously not felt to be within their reach were suddenly obtainable. They were able to meet management with a power equal to that of the mighty industrialist. Naturally, to encourage the additional signing of more members, the unions began to work for the same goals individuals had sought previously-namely, higher wages and fringe benefits, more job security, dignity, and recognition of the importance of the individual.

Labor Tactics against Employers. To achieve their goals, unions resorted to a number of devices. Chief among them was the strike. Basically, a strike is a deliberate stopping of work in order to force management to accede to certain union demands. The strike, however, may take several different forms. These are:

1. *The walkout strike:* Most common, this strike is symbolized by workers walking away from their jobs "en masse." Usually a picket line is formed, informing the public and other non-strikers of labor's side of the problem, and encouraging others not to deal with the company until the strike is resolved.

2. *Slowdown strike:* Basically an informal strike, the slowdown strike is characterized by a sudden reduction in output by the working force. Management is not notified of the strike and workers continue to be paid.

3. *Wildcat strike:* A wildcat strike is undertaken at a plant for "spur-of-the-moment" reasons, without the approval or knowledge of the national union.

4. *Sympathy strike:* This is a strike waged by members of other unions as a show of support for a union that has called for a formal strike against a company.

5. *Jurisdictional strike:* A strike called by one competing union against a company in an effort to get the company to recognize it as the proper and legal union is called a jurisdictional strike. Jurisdictional strikes were quite common before the formation of the AFL-CIO.

Other, more drastic steps occasionally used by labor include: (*a*) primary boycotts, which are, basically, a refusal of company workers to patronize the products of the struck company; and (*b*) secondary boycotts, which are refusals of workers to deal in any capacity with other businesses that handle the struck company's products. The secondary boycott, although illegal, is still occasionally employed.

Employers' Tactics against Labor. As the labor movement grew, management developed tactics to discredit and impede unionization of workers. In the 1800's, management began to use the hated "yellow-dog" contract. When a worker applied for employment he was forced to sign a sworn statement that he was not, and would not become, a member of a labor union. For years, this was an effective means of slowing unionization of company workers.

Management also utilized the blacklist-a document that was circulated among businessmen naming those individuals known to be union sympathizers. The various companies would then refuse employment to anyone on the list, thereby forcing him to move from the community, and also further hampering the development of labor unions.

Two other devices used by management are: (1) the lockout, and (2) the injunction. The lockout is a shutdown of the plant to prevent workers from coming into the plant. Generally used to prevent a slowdown strike, the lockout often lowers company losses during the strike. The injunction is a court order enjoining workers from continuing their strike.

Labor Legislation. Because labor and management tactics were getting out of hand, and many thousands of people were being hurt, Congress began passing legislation to control these two forces. The major acts that were passed were:

1. The Norris-La Guardia Act-1932. This act outlawed the infamous "yellow-dog" contract, and gave workers, for the first time, the right to join unions if they so desired. The act made it extremely difficult for employers to secure an injunction in a federal court in a labor dispute.

2. National Labor Relations (Wagner) Act-1935. Known as the Magna Carta of labor, this act is recognized today as the law that put labor on the same plane as big business, requiring that industry

bargain in good faith with the unions. It outlawed discrimination in hiring and firing labor personnel because of union membership, and it established an independent National labor Relations Board to oversee the proper enforcement of the law.

3. Fair Labor Standards Act-1938. Also known as the Wage and Hour Law, this act established a minimum wage and maximum hour requirements for covered employees. It has been amended in subsequent years, as more and more employees were brought under its provisions, wage minimums were raised, and hour requirements reduced.

4. The Labor-Management Relations (Taft-Hartley) Act-1947. In reaction to what was felt to be excessive power of the unions, this act basically amended the Wagner Act and tried to restore a balance of bargaining power between labor and management. It placed restrictions on unions. For example, it prohibited their making contributions to politicians and required annual reporting of finances and officials' salaries. It defined and prohibited various unfair labor practices and placed restrictions on labor's most powerful weapon, the strike. Outlawed were secondary strikes and boycotts, jurisdictional strikes, and strikes against the government. The act gave the President of the United States the authority to stop any strike for a period of 80 days if, in his opinion, it was in the national interest to do so.

Taft-Hartley outlawed the closed shop, as differentiated from the open shop and the union shop. The closed shop is one in which only card-carrying union members were allowed to obtain employment-the company was prohibited from employing anyone not a union member. The union shop, on the other hand, does require membership in a union, but not as a *prerequisite* for employment. The open shop does not require union membership, either to obtain employment or keep employment.

5. Labor-Management Reporting and Disclosure (Landrum-Griffin) Act-1959. This law requires secret election of officers, and the filing of annual financial statements by unions with the Secretary of Labor. Its major purpose is to provide for the regulation of internal union procedure and to further protect the rights of members of labor organizations. Its passage grew out of the disclosures of abuses by certain labor officials and the denial of rights to union members.

6. "Equal Opportunity law" (Title VII of the Civil Rights Act of 1964). In brief, this title made it unlawful for an employer, employment agency, or labor union to discriminate against an individual because of race, color, religion, sex, or national origin.

Note: There are numerous labor legislation, which is mostly found within title 29 of the United States Code. For a list and a brief summary, visit http://en.wikipedia.org/wiki/Labor_in_the_United_States.

Labor-Management Grievance Procedures

Today, there are basically four steps that can be taken to resolve labor management disputes: (1) collective bargaining, (2) mediation, (3) arbitration, and (4) compulsory arbitration.

Collective bargaining involves the representatives of management and labor sitting down to discuss their differences. Through the give-and-take sessions, both sides, hopefully, come to a reasonable understanding and agreement. Most of our modern labor-management problems are resolved in this manner.

When collective bargaining fails to produce a meeting of the minds, mediation may be relied on. Under this procedure, a disinterested third party is brought into the discussions to listen to both sides and offer suggestions. The suggestions often help the disputing parties reach an amicable settlement.

If the mediator's advice proves unsatisfactory, the disputing parties may resort to an arbitrator. The arbitrator's role is similar to that of the mediator with one important difference. The mediator can only suggest an alternative; the arbitrator can order one.

Compulsory arbitration, or the mandatory use of an arbitrator to resolve management-labor disputes, is not yet a reality in the United States, but such a course of action is being contemplated. Naturally, the passage of compulsory arbitration would probably reduce most labor and management tactics (i.e., the strike, the lockout, etc.) to a formality, since it is unlikely that any dispute would go unresolved long enough for a strike to be effective.

Current Labor-Management Problems

At the present time, there are several major areas of concern in labor-management relations. Organized labor is adamantly opposed to the "right-to-work" laws, as provided in the Taft-Hartley Act. This portion of the act allows states to pass laws regulating the legality of union shops. Presently, almost one-half of all the states have passed the so-called 'right-to-work" laws, which; in effect, outlaw the union shop and the closed shop.

Management, on the other hand, is vitally concerned about "featherbedding," a practice of keeping personnel on the payrolls even though their jobs have become antiquated. Neither of these problems has been resolved as of this writing.

In addition, a continuing dispute, affecting both labor and management, is over the pace at which employers and unions are opening wider opportunities for minority groups. Employers, accused of going too slow, respond to this charge by pointing to substantial progress and to lack of qualified black applicants for middle- and upper-level jobs. The unions have encountered violent opposition to their long-standing discriminatory practices and have moved to open more training and membership opportunities, again pointing to lack of qualified applicants. Despite Civil Rights legislation and concerted efforts by management and labor to open job opportunities to minority groups, much work remains to be done before such opportunities are fully realized by all.

Chapter 5 Review Questions

1. A strike waged by members of other unions as a show of support for a union that has called for a formal strike against a company is a

A. Walkout strike
B. Slowdown strike
C. Sympathy strike
D. Wildcat strike

2. Organized labor is adamantly opposed to the provision of regulation in the Taft-Hartley Act known as:

A. Collective bargaining

B. Mediation

C. Right-to-work laws

D. Arbitration

Chapter 6:

Production

Learning Objectives:

After studying this section you will be able to:

- Recognize key elements of the production process and building requirements.

No activity is more characteristic of the American business system than its ability to mass-produce goods. Without our tremendous productive capacities, our other advanced business technology would be worthless. Marketing of goods is important, but without the capability to produce these goods, it could not function. Finance is important, but unless we have production costs requiring the expenditures and can project a return sufficient to cover these expenditures and show a profit, it, too, would have no purpose.

The United States has always been a production-oriented country. Until the early 1900's, however, the American business system was a struggling production economy-the supply of goods fell far short of meeting the demand. Two major developments vastly increased the productivity of American industry: (1) the scientific management movement, exemplified in Frederick W. Taylor's time and motion studies, and (2) the introduction of mass-production methods, typified by Henry Ford's assembly-line techniques. Later, productivity was further increased by the development of the computer and electronic data processing, operations research (study of production problems from an overall scientific viewpoint), linear programming (expressing production relationships in mathematical formulas), and automation and cybernetics (use of automatic control systems with feedback to take the place of individually controlled machines).

Production and Manufacturing

Production can be defined as the process by which raw materials are transformed into items possessing increased value because of their form utility. Mass production is *volume* production of products that have identical characteristics or specifications. It is repetitive production on a large scale. Mass production is characterized by (*a*) mechanization, (*b*) large-scale operations, (*c*) standardization. *Mechanization* refers to the use of machines and machine power in the production of goods. For large-scale operation, we have developed large factories in which mass production can occur. Through *standardization* of the items produced, a repetitive production process on a mass scale is made possible.

Manufacturing refers to the creation of physical or tangible items that have value. Although the term *production* has a more inclusive meaning than the term *manufacturing*, the two are used interchangeably in business terminology.

Production Process

The production process can be divided into four distinct functions: (1) extractive, (2) analytic, (3) synthetic, and (4) fabricative. *Extractive* production involves the obtaining of the product or raw material from nature. For example, mining is an extractive process, since it involves the removing of a raw material (ore, diamonds, coal, gold, and so on) from its natural state.

The *analytic* production function involves those processes that separate or break down a commodity or raw material into its more basic parts. The oil-refining industry is an example of the analytic function. Raw crude oil is broken down into the component parts of gasoline, kerosene, refined motor oil, and other chemicals that are derived from oil.

The *synthetic* production concerns the procedures that "build up" or assemble a product from its basic parts. For example, the steel industry manufactures its final product by combining various elements and commodities in such a way as to create a new product not found in nature. In the steel industry, coal, limestone, and iron ore are combined to create steel.

The *fabricative* process involves the formation of consumer and industrial goods from the products produced by the extractive, analytic, and synthetic production processes. Occasionally, this function is further divided into an *assembling* function and a *fabrication* function. In either case, however, raw materials are formed into products that have a functional value. For example, steel by itself has little value, but when formed into products, such as tools and steel beams, it obtains a functional value.

The Production Cycle

Production management involves the general managerial elements of planning, organizing, decision making, and controlling. In production management, however, these elements are directly related to the questions of (*a*) product development, (*b*) production capacity, (*c*) production layout, (*d*) costs of production, and (*e*) production control.

Product Development. Product development involves the basic decision of what to produce. This decision concerns not only the general product line to be manufactured, but also considers the problems of size requirements, the desirability of different types or models of the product, and the design of the product. Because the development of new products is essential to the survival of the firm, it must be a total company effort. In a truly integrated business situation, product development will involve the opinions of the marketing personnel (who probably have the best idea of what the potential customer wants) and the finance personnel (who can translate the complexities of the manufacture of these goods into the financial needs and costs for the firm as a whole).

Production Capacity. Production capacity is concerned with those factors relating to the size of the manufacturing operation. Obviously, a primary determinant of the desired production capacity is the size of the projected market. The larger the potential market, the greater the production capacity will need to be. Similarly, the type of product, the size of the market, and the desired level of output will greatly influence the type of building that will house the production facility. The decision on the type of building will have to consider such factors as (*a*) impact on employee morale, (*b*) cost, (*c*) storage space, and (*d*) the efficient movement of material and product through the plant.

Questions regarding machinery needs will be considered in this phase of the production cycle also. Whether the factory will utilize blast furnaces, numerically controlled machines, or large assembly lines will enter into this phase of the production decision.

Production Layout. The production layout will depend on the nature of the product being produced. Some goods are produced continuously referred to as continuous production), that is, the machines and labor are producing around the clock. Steel companies produce continuously, since it would entail too much wasted time and money to reheat the blast furnaces every day. Other companies produce intermittently (referred to as intermittent production), that is, they produce goods during part of the day only. Most companies produce on an intermittent basis.

Similarly, some goods can be mass-produced. Such items require a certain layout to facilitate the continuous flow of materials. Other companies produce goods on a "custom-made" basis. For such goods, the internal plant layout may be completely different than that used for a mass-produced item.

Cost of Production. The fundamental cost considerations regarding production are twofold. The first cost factor concerns the level of *fixed* costs that need to be incurred in order for production to occur. Fixed costs are those costs that must be incurred regardless of the level of production undertaken. For example, the cost of heating the plant, taxes, executive salaries, and fixed depreciation expenses of machines are cost that remain fairly constant even though production varies. The second cost factor incurred by the business firm involves *variable* costs. These are costs that vary directly with the level of production undertaken. Examples of these costs would be wages paid to laborers, electricity used to run the machines, cost of storage of goods, and to some extent, the fuel used to run the machines.

The level of fixed costs is a vital factor in determining the *break-even point.* The break-even point is that level of output that must be produced and sold in order for revenues to exactly equal costs. it is, in essence, the level of output necessary to produce zero profit. Obviously, the sooner a firm can reach its break-even point, the sooner it will begin making profits. It should be noted that firms utilizing continuous production usually have a higher level of fixed costs-and, therefore probably have a higher break-even point than firms producing intermittently.

Production Control. The final stage in the production cycle concerns production control. Production control involves the activities of (1) routing the materials of production through the plant, (2) inspecting the production channel for ways of improving and increasing output, (3) controlling the purchase of raw materials that enter the production cycle, and (4) managing the inventory of finished goods that are awaiting sale.

Agile Technology

Strategic planning has traditionally relied on forecasts of market conditions and customer needs. But in today's uncertain business environment, it is difficult for companies to look far into the future. Instead, they have to spot trends early and respond more quickly than competitors to opportunities and threats.

The "Sense-and-Respond" Model : A New Operating Model

The logic of "make-and-sell" still dominates the thinking of large industrial groups. It assumes that competitive advantage comes from economies of scale, that customer needs can be predicted and even influenced by the company, and that operations should be designed to maximize efficiency and utilization of fixed assets.

The make-and-sell model works well when markets are stable and change is slow. However, when change is rapid and markets are volatile, companies need a different operating model that values flexibility over efficiency and speed over scale. This "sense-and-respond" model is about anticipating customer needs and swiftly responding with the appropriate capabilities and customer offerings. This creates a “unique value proposition” of rapid response and reliable delivery times that gives it an edge over competitors.

Modularity and Agility

How does a company become agile without destroying its scale advantages? In the make-and-sell model, variety is an evil because choice is the enemy of scale. Customers now demand variety but this comes at a cost. So how can a company become agile without compromising its cost position? The key is modularity of products and information technology systems, and decoupling of business processes and value chains.

To increase the agility of offerings, companies are embracing modularity in their product platforms, which allows them to create a diverse array of products with a relatively small number of components and sub-systems.

Business processes can also be made more agile and more effective by decoupling the front-end of the business process (the end closer to customers and markets) from the back-end of the business process (the back-office processes that support the front-end). The back-end can then be centralized to create shared services, and it can also be relocated to places where resources are more cost-effective.

Chapter 6 Review Questions

1. Mass Production is volume production of products with identical characteristics or specifications that does NOT include:

A. Research and development

B. Mechanization

C. Large scale operations

D. Standardization

2. The decision on the type of building will consider:

A. The efficient movement of material and production throughout the plant

B. Analytical production

C. Synthetic production

D. Fabrication process

Chapter 7:

Purchasing

Learning Objectives:

After studying this section you will be able to:

- Recognize key elements of the purchasing-supplier relationship.

Purchasing is a function of business that is easily one of the most important in a business enterprise. Evidence of this importance is the fact that over 50 percent of the cost of manufacturing a product is related to the purchasing function.

By definition, purchasing involves acquiring the proper amount of materials to be used in the manufacture of finished products. Moreover, acquiring the right *amount* of raw materials is only part of the purchasing function. That "right" amount must be delivered at the "right" time to the "right" place. A breakdown in any one of these steps can nullify all the cost savings realized in the other steps.

To execute the purchasing function, most large companies have a distinct division set up within the corporate organization, headed by a purchasing agent or a vice president in charge of purchasing. Although the procedures and mechanics involved in the purchasing function are somewhat standardized, they do vary with the nature of the item being purchased.

The Purchasing Function

The purchasing function begins with a determination of the materials that are needed by the production department. Usually, the production manager and the engineers in charge of production draw up the specifications for the raw materials they need, specifying such things as strengths, qualities, and chemical-physical properties. They may even specify a brand name of goods to be purchased. Usually, they will include a statement indicating the purpose of the part so that the purchasing agent can better evaluate alternative sources of supply.

After receiving the purchase requisition from the engineering and production departments, the purchasing agent begins searching out the alternative sources of supply. He may utilize his own knowledge of such suppliers, or he may follow the suggestions of others in locating a supplier. More probably, however, he will search through the various trade directories and registers for the names of potential suppliers. He may even refer to journals and trade magazines.

Selecting a Supplier. Once the possible suppliers have been located, the problem of choosing the best one remains. With the multitude of objectives facing the purchasing agent, he must choose his suppliers carefully. He must consider the quality of the product provided by each supplier. He must also consider the service provided by the supplier, as well as the desirability of concentrating his purchases with one supplier or diversifying his purchases among several suppliers.

The service aspect of choosing a supplier involves three primary responsibilities: (*a*) delivery, (*b*) maintenance, and (*c*) shipping. The purchasing agent must be assured that the supplier can deliver the goods when promised. Poor or erratic service on delivery can undo all of the careful planning of the purchasing agent. Similarly, the purchasing agent must determine the capacity of the supplier to provide maintenance, if required. Although this service is not a consideration for material acquisitions, it is a vital consideration for purchases of equipment to be used within the company, such as typewriters or computers.

Certain considerations regarding shipping procedures should be made. These considerations include the way in which material is to be transported, the costs associated with handling the material, and the ease with which it can be handled and transported.

A final consideration, and certainly one of the most important ones, concerns the price of the product. Prices can be arrived at in several ways. For example, some companies (including the U.S. government) issue requests for bids on merchandise desired, from all possible suppliers. From these bids, the company (or purchasing agent) chooses a supplier. Obviously, under this purchasing procedure, price is all important as a consideration in choosing a supplier. Other suppliers issue catalogs indicating the prices of their merchandise, to which the purchasing agent can refer for the necessary price information.

Purchasing agents seldom buy at list or retail prices, and therefore discounts offered by suppliers are a factor in their selection. There are three main kinds of discounts: trade, quantity, and cash.

Trade discounts are discounts offered by a supplier to purchasers as a matter of policy. Under the Robinson-Patman Act, suppliers are forbidden from discriminating among purchasers in offering these discounts. That is, all purchasers of goods are entitled to the same trade discount that was offered to all other purchasers of the same class. Unfortunately, the law enforcing this "nondiscrimination" clause is difficult to enforce, particularly when one purchaser buys numerous items that are difficult to classify.

Quantity discounts are discounts offered to purchasers of large amounts of the item. Such discounts are justified because large purchases relieve the supplier of storage problems, and also tend to increase his profitability. Usually, these discounts are open to negotiation.

Cash discounts are discounts offered to purchasers as an incentive for quick payment for the merchandise acquired. Cash discounts are usually offered to all purchasers, although the terms may vary considerably.

Determining Quantity. After selecting a supplier and agreeing on the financial terms of the transaction, the one remaining problem concerns the decision regarding the quantity to be purchased. "How much to buy" is a continually changing and perplexing problem. The ultimate answer depends to a great extent on the decisions reached regarding the following questions:

1. What is the current stock on hand? The larger the stock on hand, obviously, the less the amount needed immediately will be. This is usually the case except in situations where the goods in question are seasonal in nature. Then, other factors are usually more important in determining quantity purchased.
2. What is the cost of the goods purchased? If the goods in question have a high unit cost, or if for any reason the purchase of the goods will cause a severe drain on a company's cash reserve, the quantity purchased may be limited.
3. What storage is available for the goods? If ample warehousing is available, the purchasing agent may desire to procure more of the item than if such warehousing and storage were unavailable.
4. Are quantity discounts available? Frequently, the availability of quantity discounts will encourage the purchasing agent to acquire more of the good than he otherwise would.
5. What is the rate of use of the item? Naturally, this question is vital, for the more rapidly the item in question is consumed, the more of the item the purchasing agent will be interested in acquiring at any one time.
6. What are market conditions regarding this good? The question of obsolescence is of critical importance and is closely related to the use rate of the item in question. The greater the chance of obsolescence, the less likely is the purchasing agent to acquire large quantities of the item.

After deciding the quantity to be purchased, the purchasing agent places the order, and then is faced with the responsibility of follow-up. Spot checks with the supplier and with the transportation company waiting to ship the goods should enable the purchasing agent to keep close tabs on the time the goods should reach the warehouse. After the goods have been received, the purchasing agent should attempt to obtain feedback from the production department regarding the quality of the items purchased.

Other Purchasing Policies

There are several policies that affect the purchasing agent's efficiency in handling his job. The problem of concentration or diversification of suppliers has already been mentioned. If all of an item is acquired through one supplier, production difficulties of that supplier will cause similar problems for the purchaser. On the other hand, concentrated purchases usually enable the purchasing agent to maximize the use of quantity discounts and to build an excellent rapport with the supplier.

The problem of *reciprocity* is encountered continually by purchasing agents. Reciprocity refers to a "you buy from us and we'll buy from you" attitude. Companies that frequently use each other's products are tempted to engage in reciprocity. Such practices are not condoned, however, by top management, for they frequently result in an inefficient purchasing decision. When companies engage in reciprocity, often the purchasing agent overlooks the fact that other suppliers may offer better terms, better service, or a better price.

Speculative buying is another tempting purchasing policy, and although profitable for those agents successful at it, it can be highly damaging to a firm whose purchasing agent is not so successful. Speculative buying refers to the purchasing of more goods than are needed at the time, in anticipation of a price increase in the item, or some other unfavorable change in market conditions. When such anticipation is well founded, speculative buying can be highly profitable for a firm. When, however, such buying does not correctly anticipate forth-coming market conditions, the resulting damage can be disastrous.

Contract buying is another popular purchasing policy. This refers to the contracting with a supplier for delivery of supplies or goods for some predetermined period, usually a year. During this time, the supplier agrees to provide for a flat fee all such service or goods required. The purchasing agent is likely to attempt contract buying when he feels the price is attractively low. In this way, he also assures his company of a continuing source of supply for the period covered by the contract.

The purchasing agent's relations with suppliers' sales persons are important, for they are the eyes and ears of a good purchasing agent. From them, he can learn of new product developments and thereby provide better service to his firm's engineers, for it assists them in determining the specifications of the products the purchasing agent will eventually acquire. It is, therefore, vital to successful purchasing that good relations be maintained with these vendors.

The Ethics of Purchasing

One of the most pressing concerns for the purchasing agent is to maintain a high standard of ethics in his profession. If he accepts "kickbacks" or expensive gifts and lavish entertainment he cannot remain free to do his job in the best interests of his firm. Even the acceptance of modest entertainment and "gifts" from potential suppliers for Christmas, birthdays, or other occasions can exert undesirable influence on purchasing decisions. The pressure that can result from suppliers entertaining and giving gifts to purchasing agents can be so detrimental to efficiency in purchasing that many firms have policies prohibiting these activities.

Chapter 7 Review Questions

1. The percentage of the cost of manufacturing a product related to the purchasing function is:

A. Ten percent

B. Two percent

C. Less than twenty-five percent

D. More than fifty percent

2. Purchasing agents seldom buy at:

A. Trade discount prices

B. Quantity discount prices

C. Retail prices

D. Cash discount prices

Chapter 8:

Plant Location

Learning Objectives:

After studying this section you will be able to:

- Identify key selection factors for production facility location.

The wide dispersal of similar types of successful businesses throughout the country might seem to suggest that plant location is not a life-and-death matter. It would be hard to prove that specific industries-the auto industry, for example-might not have done as well if concentrated in some other location. However, certain factors involved in location can be clearly distinguished which obviously *do* have an effect on costs, efficiency of operation, and price, and hence, on the ability of a business to compete successfully.

Location of Manufacturing Facilities

The factors affecting plant location may be loosely classified as *geographic* or *community* factors. Both are important to the successful choice of a plant site.

Geographic Factors. Six major geographic factors in effective plant location need to be taken into account: (1) closeness to sources of raw materials and supplies, (2) nearness to markets, (3) favorable climate, (4) availability of low-cost electric or other power, (5) sufficient water, and (6) easy access to good rail, truck, water, or air transportation.

Nearby sources of raw materials and supplies can be of critical importance. A firm cannot compete effectively if it must spend large amounts of money to move its essential materials long distances. For some firms, perishability of its basic raw materials may require proximity of the plant site to sources of these materials. In cases when the raw materials used are heavy and bulky, as with iron ore, hauling over long distances must be avoided.

The nearness to its markets can be of great importance to a firm, since proximity to market enables a business to give better service and reduce transportation costs. Companies engaged in synthetic manufacturing, such as paint manufacturing, cement production, and so on, or those specializing in providing goods and services to other industries (such as suppliers of electronic components to business machines manufacturers), find that the location of their customers is the prime consideration in determining where their plants will be located.

Although companies engaged in making products affected by climatic conditions will tend to locate where climate is a favorable factor, this is not as important as it once was. This is because air conditioning can make it possible to manufacture products sensitive to heat and humidity even in subtropical Florida or the Deep South. Naturally, some agriculture-related industries find the climate important. These firms want to locate near their agricultural customers and therefore climate becomes quite important. These considerations, however, tend to exist only in selected industries.

The availability of power and power supplies can be a critical factor for many large companies. Industries engaged in the manufacture of aluminum, for example, find that the factor of power supply to be *the* critical factor in determining where they will locate.

Water supply is another critical factor for some companies. Steel companies and chemical companies find their consumption of water to be high enough to warrant giving this factor special consideration in determining plant location.

Finally, the question of adequate transportation facilities is a critical one to most businesses. One reason industry tends to locate in or around seaports, major highways, or railroad terminals is because of this consideration. Similarly, industry has been reluctant to locate in any area lacking adequate transportation facilities.

Community Factors. What kind of community makes a good site for a plant? Some determining factors are: (*a*) the supply of workers, (*b*) other business facilities already in the community, (*c*) attitude of the local government and the degree of acceptance of the plant by the people of the community, (*d*) inducements that communities often grant to attract industry, and (*e*) the quality of the community as a place for employees to live. Other important considerations are local land prices, building costs, and taxes.

The supply of workers available at any location is vital to any labor-intensive industry. for certain companies, the question of a work force extends beyond the mere availability of workers; it also concerns the quality of the available work force and the union position within the community lacking skilled workers or workers who can be trained for skilled jobs.

The other business facilities that are available to a new business can be an important factor. The bank facilities, for example, might prove to be a vital factor for location of capital-intensive industries. Similarly, the availability of other related or complementary businesses can be of great importance to some companies.

Another important community factor to be considered is the attitude of the local government. Zoning ordinances, sewage and garbage disposal facilities, and police and fire protection are all considerations that are indicative of the attitude of the local government toward attracting new industry into the community. Ideally, too, the people of the community should welcome the plant and not regard it as an adverse element in the community.

Local inducements to locate in a given community can prove to be an important consideration. Some locales offer industrial parks for locations, some offer tax-free operation for several years, and there are other inducements. Such inducements can often be a deciding factor in a business moving to a new community.

Finally, it is important that the community provide an environment that will be attractive to the firm's employees and their families. The availability of adequate educational institutions, churches, hospitals, shopping centers, and cultural facilities can often determine whether a firm can successfully locate in any given community. If these things are lacking, the company may have difficulty in getting personnel to move to the community.

Geographic and community considerations regarding plant location are not restricted to the location of manufacturing facilities, however. Retail facilities need to be just as aware of these considerations as do manufacturing facilities. Indeed, retail operations need to consider factors that are not necessarily vital to a manufacturing enterprise.

Location of Retail Facilities

The merits of a retail location will be determined mainly by the numbers of present and future customers accessible to it, the amount of income they have to spend, and the complex of factors that affect their buying choices. Additional factors are competition in the area, and the advantages or disadvantages of the location in relation to the flow of traffic.

Population data and projections of future growth are relatively easy to secure, and they provide clues as to the present and potential number of customers that can be reached from a particular location. Similarly, the level and distribution of income among these customers can be estimated and projected. Expenditure patterns --the types of products for which these customers will likely spend their money-will be influenced by any number of determinable factors; size and location of the community, age composition of the population and the number of families with children , educational level, occupational level, nationality and racial composition of the population, and social status.

It is known, for example, that buying patterns differ among people living in large cities, rural areas, and the suburbs. People in different parts of the country, despite the tendency for differences to lessen, still have preferences for different products.

The age composition and place in the family life cycle of the population to which a particular retail location gives access will determine buying preferences and hence the value of the site for a particular type of retail store. For example, if the population is growing because of new families with children entering the area, it would be favorable to a store specializing in children's clothing; if the increase were due to an influx of elderly people, the growth would actually work in reverse for such a store.

Similarly, the other customer characteristics we have mentioned play an important role in determining the appropriateness of certain retail locations for particular types of retail business. People with low incomes, little education, and lower social status will have buying patterns differing in many respects from those of customers with high incomes, higher educational and occupational levels, and higher social status. Stores catering to particular national or racial groups must take these factors into account in making a location decision.

The extent of the competition at a location is a vital consideration. An area already being served by a dozen carry-out restaurants might not be able to support another. On the other hand, some types of business might be helped by the proximity of similar businesses. A retailer might wish, for example, to (*a*) locate on the opposite side of town from his nearest competitor, or (*b*) locate in an area having a number of similar businesses to which customers come to buy particular products.

Finally, flow of customer traffic may affect the value of a location. Corner locations will attract more traffic than those in the center of a block. Sometimes one side of a street will be more favorable than the other. Similarly, the lack of availability of ample customer parking facilities may hamper a good retail establishment.

Retail Store Layout. The problem of location also exists within the store in connection with store layout. It has been found that store layout can have an appreciable effect on sales. Certain principles of layout have been developed, especially by supermarkets, discount outlets, and department stores. Things are arranged so that the customer cannot check out without at least visiting a few sections of the store. High-frequency items are given preferred locations in the stores. Impulse items are frequently placed at points of greatest visibility. Meat counters in supermarkets frequently are placed along the entire width of the rear section of the store so that customers going up and down aisles will have a number of chances to visit them.

Self-service stores utilize merchandise racks for display purposes. Customers can serve themselves from the racks. Discount stores frequently put the loss-leader items in the rear of the store so that the customer will be required to pass other merchandise to get to the sale items.

Chapter 8 Review Questions

1. Community factors that determine a good plant site may include:

    A. The supply of workers

    B. Nearness to the market

    C. Favorable climate

    D. Availability of low cost power

2. Customer characteristics that can play an important role in their buying choices will not include:

    A. Area level competition

    B. Income level

    C. Education level

    D. Social status level

Chapter 9:

Information Technology and Management Information Systems

Learning Objectives:

After studying this section you will be able to:

- Recognize various computer hardware and information systems.

Businesses now have available to them sophisticated systems for gathering, storing, and processing data. This data is used internally in decision making, and externally to meet the requirements of customers, creditors, stockholders, and governmental agencies. An information system is a computerized system which processes data (facts) and produces information. This process is defined as an information processing cycle (IPC). The information processing cycle consists of four operations. They are input, process, output and storage. The retrieval of raw data from the environment and delivering it to the computer is called input. After the computer receives data from the input device it will manipulate, refine and process the data to produce useful information for users. This step is called processing. After data has been refined and manipulated into useful information, the information is displayed to the end users and that is called output. Finally, the information needs to be saved for further usage. That is the storage step. All four processes make up the Information Processing Cycle. The Input of the IPC is raw data. Raw data consists of raw facts while information is a collection of facts organized or processed in such a way that they have additional value for further usage.

Information itself has value, and commerce often involves the exchange of information, rather than tangible goods. Information is valuable and useful because it can help decision makers. For example, investors are using information to make multi-million-dollar decisions, financial institutions employ information to transfer millions of dollars. Retailers use information to control inventory and process orders. Information technologies are consistently changing our society , our ways of doing business and our lives. To fully understand what an information system is and its concepts, the components of information systems should be first identified. A complete information system should contain the following elements:

Computer Hardware

Computer hardware can be classified into five categories: personal computers, servers, minicomputers, mainframes and super computers.

Personal Devices

Personal computers are also called microcomputers. Each contains a microprocessor and is designed for individual or personal use. Classifications within this category include desktop computers and portable computers.

Desktop computers: They are the most popular type of microcomputer and are designed to fit on the top of a desk. With the same options in the system, desk top models are the least expensive.

Workstations: Workstations are the most high-end personal computers. They are more powerful and expensive than any other personal computers. Very often, they are used to be the file servers in a network environment. Many engineers also use workstations to aid in product design and testing. Workstations are very good in calculations and graphics.

Notebook (Laptop) computers: They are the largest portable computers in this category. They weigh between three and ten pounds and have a hard drive, DVD/CD-ROM drive, CD-RW drive, and other equipment.

Tablet computer (tablet PC): A full power PC in the form of a tablet. It looks like a notebook computer without a keyboard, although it usually can be connected to a keyboard and a mouse. iPads are the leading example.

Smart Phones: Phones are rapidly becoming a handheld computer that is small enough to fit in the palm of a hand. Increasing mobile applications are allowing remote employees and customers to access a wide range of web sites and business applications. As more and more information is stored on the cloud, the ability to access data remotely is ever more important.

Servers

Server computers are designed to support a computer network that allows users to share files, applications, and hardware resources. A server computer is normally used to serve other computers in the network in terms of file storage and resources management, data communications, printing management, and other computer functions. The characteristics of a server computer follows:

- Communicate with other networks
- Enhance communication speed within the network
- High-end CPU power with a large capacity on the hard drive
- Some have parallel processing capabilities by employing more than one CPU.
- Large memory capacity

A server computer could be either a high-end microcomputer or a powerful microcomputer with minicomputer like functions.

Mainframe Computers

Mainframe computers are large computer systems that can handle hundreds of users, store large amounts of data, and process transactions at a high speed. Mainframe computers use a very sophisticated computer operating system to manage and control the whole system. Mainframes usually require a specialized environment including air conditioning and raised flooring that allows computer cables to be installed underneath. The price range for mainframes is from several hundred thousand to several million dollars.

Supercomputers

Supercomputers are the most powerful category of computers. Typical applications are scientific calculations, engineering design , space exploration and other tasks requiring complicated processing. Supercomputers cost several million dollars.

Computer Software

Computer software consists of instructions called programs written in programming languages by programmers. Software consists of sequences of operations the computer will follow. Before a program can run or be executed, the program must be loaded into the main memory of the computer. After that, programs can be executed to perform certain functions based on how they are designed. For example, the word processing program allows users to enter their typing and edit the contents. A graphical design program is used to perform graphical designs. Most computer programs are written by people with special training. These people, called computer programmers, write the necessary instructions.

System Software

System software consists of programs that are used to control and operate the computer hardware. There are three components in system software: Operating system, Utility programs, and Language processors. The operating system tells the computer how to perform functions such as how to load, store and execute programs, how to transfer data between input/output devices, and how to manage resources available (CPU time). To operate a computer, the operating system must be loaded in the main memory first. Other application software can then be loaded into the computer by the help of the operating system. Utility programs are designed to perform functions which are not available in application software such as formatting a diskette and creating a directory.

Application Software

Application software consists of programs to perform a specific user's task such as preparing a document, designing a financial worksheet and creating a useful database. When you think of the different ways that people use computers to improve the efficiency in their work place, they can be classified as application software. Most users do not write their own software programs. (Either system software or application software) They can buy ready to use software. These programs can be called software packages.

Data

Data are usually the input of a Management Information System. After data are processed by MIS, information will be generated. Users can then use information for decision making. Data is normally entered into files or tables, which are then organized into database. Users can retrieve data as input of application software and produce information as output. If data are not accurate, the information produced will not be useful. Therefore, the garbage in, garbage out (GIGO) syndrome should be avoided.

Trained Personnel

People who operate MIS should be properly trained. MIS professionals and programmers are responsible for designing and programming MIS, while computer operators and users use them. With adequate training, users can achieve the desired functions designed by MIS professionals. An experienced user can also provide MIS professionals with valuable suggestions or be involved in MIS development.

Procedures

MIS procedures are designed for users to achieve certain functions. Well-designed procedures guarantee the quality and the security of information processing.

Information systems that are implemented on a computer can be classified into five different systems:

A. Transaction Processing Systems
B. Management Reporting Systems
C. Executive Information Systems/ Executive Support Systems
D. Decision Support Systems
E. Office Information Systems

The following sections will be used to describe the above systems.

When to Use Transaction Processing Systems (TPS)

Transaction information systems are designed to process the day-to-day transactions of an organization so that many labor-intensive business transactions can be replaced by automated processes. These transactions have characteristics of large numbers and routine processes. Each process has a very simple data transaction, and TPS is expected to process each one in a very short period of time. Examples are super market grocery checkout (billing systems) or bank transaction processes.

When computers were first used for processing business applications, TPS was the primary system implemented to replace the manual system currently used. Typically, a successful TPS can improve transaction efficiency, customer service, and reduce transaction costs. The first TPS was a batch system. A TPS in batch processing implies that all transactions are collected first and at a later time, processed. The disadvantage of batch processing is that information cannot be updated immediately. A TPS with on-line processing updates information when the transaction is entered. In a business where immediate update is required, an on-line TPS is necessary. On-line TPS requires higher fees for operation than batch TPS. Today, most TPS use on-line processing to achieve better customer satisfaction and current information.

When to Use Management Reporting (Information) Systems (MRS)

After TPS has been implemented, some organizations realized that the results produced by TPS do not satisfy for higher-level decision making and that the computer's capability to perform rapid calculations and logical functions could be used to produce meaningful information for management. As the result, MRS began to be developed so that managerial reports and summarized data can be produced. These reports helped managers perform their duties as well as to provide middle management with statistical or summarized data for tactical level decision making.

In general, MRS is usually used with TPS. TPS processes daily transactions, updates inventory, and keeps customer information while MRS uses the data from TPS to produce daily total sales, inventory ordering lists, and customer lists with different criteria. The output from MRS provides middle management with printed reports and inquiry capabilities to help maintain operations and management control of the enterprise. The concept of management reporting systems evolved as managers realized that computer processing could be used for more than just day-to-day transaction processing, it could also be used to produce meaningful information for management.

Frequently, a MRS is integrated with a TPS and the input source of MRS is usually the results of TPS. For example, a sales transaction can be processed by using a TPS to record the sales total and customer's information. A MRS can further process these data to generate reports on average sales daily or fast moving items.

When to Use Decision Support Systems (DSS)

Decision Support Systems are designed to help managers reach a decision by summarizing or comparing data from different resources. They are suitable for semi-structured and unstructured problems. Decision support systems often include query languages, statistical analysis capabilities, spreadsheet, and graphics to help decision makers

Evaluate the decision. DSS are a type of MIS expressly developed to support the decision making process. DSS facilitate a dialogue between the user, who is considering alternative problem solutions, and the systems, with its build-in models and accessible database. A typical DSS process involves retrieving a model from the model base and allocating proper data from the database.

With a model, users can ask if-then questions by changing one or several variables as the input, the combination of data and model generates the recommendations from a DSS. The database is managed by a Data Base Management System (DBMS) while a model base is managed by a Model Base Management System (MBMS). Some DSS allow users to create models for better evaluation. For example, the vice president of marketing may want to know the net effect on company profit if the advertising budget decreases. TPS and MRS usually do not provide this type of information.

When to Use Office Information Systems (OIS)

OIS is a system designed to support office tasks with information technology. Voice mail, multimedia system, electronic mail, video conferencing, file transfer and even group decisions can be achieved by Office Information Systems. The final goal for OIS is to have an office environment where no paper should be used (paperless environment).

When to Use Executive Information Systems (EIS)

EIS is designed to generate information which is abstract enough to present the whole company operation in a simplified version to satisfy senior management. Characteristically, senior managers employ a great variety of informal sources of information, so that computerized information systems are able to provide only limited assistance. However, the CEO, senior and executive vice presidents, and the board of directors also need to be able to track the performance of their company and of its various units, assess the business environment, and develop strategic directions for the company's future.

In particular, these executives need a great diversity of external information to compare their company's performance to that of its competition, and to investigate the general trends of the economies in the many countries where the company may be doing business. EIS is therefore, designed to address the information needs for senior management who may not be comfortable working with computer systems. EIS also provides features that make them easier for executives to use. EIS provides a graphical user interface that can be mouse or touch screen oriented. EIS relies heavily on graphic presentation of both the menu options and data.

Why Do You Need MIS To Solve Your Business Problems?

The business environment is changing on a daily basis. The competition is everywhere from cost cutting to marketing strategies. To maintain competitiveness, management must improve the efficiency of operation without sacrificing the quality of products and services. In order to achieve this task, making timely and correct decisions is the key to success. Since good decision making requires quality data and timely information, MIS is exactly designed to provide information on a timely basis. MIS also provides different types of information based on users' needs to improve effectiveness and efficiency.

Computer Technologies Available For Business

Information systems are used in all business domains. For example, finance uses information to forecast revenues and maximize investment, make selections on stocks and even predict bankruptcies. Accounting uses information systems to record transactions, prepare financial statements, manage cash flow, or predict profit or loss. In marketing, information systems are used to develop new merchandise and services, customer segmentation, determine the locations for production and distribution facilities (so that the cost can be reduced and more customers will be attracted), develop formulate price strategies (so they can maximize total profits) and even develop the promotion policies (so that advertising will be more efficient). In manufacturing, information systems are used to process customer orders, develop production schedules, design new products, and test the quality of products.

In addition, network technologies allow users to share information and other resources. As a result, information retrieval can be more efficient and available. Current Internet technology provides businesses with a variety of external business information. A multimedia information transmission (text, graphics, image and video) is also available on the Internet. With the impact of Internet, Intranet becomes another new technology popular to business. Intranet is a small version of Internet in one organization. It provides almost the same services as the Internet would do but with better security and privacy. Artificial Intelligence technologies are also applied to business functions. Neural networks have been used to predict the stock and bond markets. Expert Systems are used to help managers with financial decisions. In the future, more intelligent agents will be used in the business environment to improve the quality of services and products.

How to Manage Your Information Resources

Information resources could be a very complicated task due to rapid changes in this field. Generally speaking, there are two options available to managers:

1. In-House Operation
2. Outsourcing

In-house operation requires your own data processing facilities and personnel to operate. This approach allows users to receive MIS services faster and easier. However, it requires the company to use the equipment and employ MIS personnel to assure the facility is fully functional.

Outsourcing deals with subcontracting MIS tasks to professional MIS companies. With professional help, the task can be achieved more efficiently and effectively. However, the response time to acquire services might be a little longer and very often, the communication channels between subcontractor and users might not be well established. Different MIS is designed for different management functions. To understand which MIS will serve specific management needs, we categorize management into three levels.

First level:

Strategic management is the highest level of management. This level contains fewer decision makers but controls much power over the whole organization. Therefore, EIS becomes the most appropriate IS available at this level.

Second level:

Tactical management is the middle level of management. Managers in this level very often use MRS for summarized information and generate management reports for decision making.

Third level:

Operational is the lowest level of management. Foreman and supervisors are in this level. TPS with large routine transaction processing capability is usually used for this management level.

In addition, DSS and OIS are not specifically designed for any management level. They are good for all three levels of management.

The Role of information Technology (IT)

Our lives and organizations have been engulfed by information technology (IT). Ideas, information, and relationships are becoming more important than production machinery, physical products, and structured jobs. The world of e-business is booming as more and more business takes place by digital processes over a computer network rather than in physical space. E-commerce is a narrower term referring specifically to business exchanges or transitions that occur electronically. The role of enterprise resource planning systems (ERPs) that unite a company's major business functions—order processing, product design, purchasing, inventory, etc. ERP weaves together all of the company's systems, managers anywhere in the organization can see the big picture and act quickly, based on the up-to-the-minute information. ERP prompts a new approach to management—a companywide management system in which everyone has instant access to critical information. Knowledge management refers to the efforts to systematically find, organize, and make available a company's intellectual capital and to foster a culture of continuous learning and knowledge sharing so that a company's activities build on what is already known.

Chapter 9 Review Questions

1. The retrieval of raw data from the environment and delivering it to the computer is called:

A. Storage

B. Output

C. Input

D. Process

2. Computer's that are designed to support a computer network that allows users to share files, applications, and hardware resources are:

A. Personal computers

B. Server computers

C. Tablets

D. Mainframe computers

Chapter 10:

Accounting

Learning Objectives:

After studying this section you will be able to:

- Recognize the components of financial statements and popular financial analysis ratios.

Accounting is the art of recording, classifying, and summarizing business transactions and interpreting their effects in a business firm. Accounting can be distinguished from bookkeeping in that the bookkeeper is involved only in some of the recording, classifying, and summarizing aspects of the accounting function. The bookkeeper remains a *part* of the accounting function, but does not encompass nearly the managerial significance of the accountant himself.

The accounting function is of major importance to several groups. Management relies heavily on the accountant's advice in making managerial decisions. Creditors expect the accountant's reports and statements to disclose the nature of debts of the business and to show the true financial position of the firm. Owners rely on the accountant to measure the earnings of the firm and to provide information that is useful in evaluating the competency of management and in making future investment decisions. Government is interested in the results obtained by the accountant, for he determines and reports the firm's taxable income. Finally, labor is concerned about the accounting function, for results obtained by the accountant often weigh heavily as a consideration in collective bargaining.

The accountant's function, however, is not limited to serving business. The accountant finds his way into public service, either as an independent auditor, a government employee, or a consultant. One of the most prestigious positions is that of a certified public accountant (CPA). The tendency of those accountants who do decide to work in industry has been to specialize in such things as budgetary control, tax accounting, auditing, or cost accounting.

The Accounting Procedure

Recording and Summarizing Transactions. The principal device used in recording and summarizing transactions is the *account,* a means of showing increases and decreases in a single balance sheet item. In its most elementary form, it looks like the letter "T" and is known as a T account. More generally, the left side of any account is called the *Debit* (Dr.) side and the right the *Credit* (Cr.) side. These terms are not the same as "increase" or "decrease." They are part of the mechanics of *double-entry* bookkeeping, which requires that every transaction be recorded in two or more accounts with equal debits and credits. This system provides a means of disclosing any errors. Accuracy is periodically tested by the preparation of a *trial balance.* If such trial balances do not balance, errors are indicated.

It would be possible to record transactions by entering debits and credits directly in the accounts but to do so would be to invite error. Consequently, it is common practice to record all transactions in a *journal* and then to transfer the separate journal entries into individual books of account called *ledgers*. From the ledgers are prepared the most important financial statements the accountant develops: the *balance sheet* and the *income statement.*

The Balance Sheet

The balance sheet is a statement indicating the financial structure of a business firm as of a specific date. The balance sheet generally is divided into three parts. One section shows the firm's *assets;* a second section shows the firm's *liabilities;* and a third section shows the firm's *owners' equity* (or property rights of the owners of the firm).

On the left side of the balance sheet (or sometimes at the top) are listed the assets of the firm. On the right side (or below) are listed, respectively, the liabilities and the amount of the owners' property rights, or equity. The assets of the firm must always equal the total of the liabilities and owners' equity, because those properties that were not financed by the owners' money were obviously financed by creditors. This concept leads to the fundamental accounting equation:

Assets	=	Liabilities	+	Owners' Equity

Owners' equity may also be referred to as *proprietorship, net worth,* or *capital,* but *owners' equity* is the preferred term.

ASSETS. The assets of the firm comprise all items, both tangible and intangible, that are generally considered properties or rights of the company. These assets can be divided into three primary categories: (a) current assets, (b) intangible assets, and (c) fixed assets.

Current assets generally are defined as cash and properties that are expected to be consumed or transformed into cash within the normal operating cycle of the business, usually a year. Besides cash, such items as accounts receivable, prepaid expenses, investments, and inventory are usually considered current assets.

Occasionally, a firm owns rights to certain processes-patents, for example-or has a copyright on some published material. These processes or rights have no physical substance-they are merely legal rights. Such items are considered *intangible assets*.

Physical plant, including buildings, land, and equipment, or other properties expected to remain of value to the business over a long period, are classified as *fixed assets.* Because fixed assets are consumed over a period of time (with the exception of land), the accountant allocates a portion of their original cost as a business expense in each period. This charge is called depreciation.

LIABILITIES. Liabilities generally are debts owed by the business firm to others. Typically, liabilities are of two types, current and long-term.

Current liabilities are obligations that are expected to be paid in full within a short period, usually one year. Because the maturity on current liabilities matches the life (or expected life) of current assets, businessmen frequently finance current assets with current liabilities, expecting to use the cash generated from the liquidating assets to pay off the liabilities. Examples of current liabilities are accounts payable, salaries payable, and taxes payable.

Long-term liabilities are obligations that become due at some time in excess of one year. Typical of long-term liabilities are mortgages, long-term notes payable and bonds payable. It is common to use long-term financing to purchase long-term assets.

OWNERS' EQUITY. Owners' equity represents the interest of the owners in the assets of the business. Owners' funds with which to purchase assets may have been obtained through the sale of common or preferred stock or through the retention of earnings. Common and preferred stock are the formal securities indicating ownership in the business. Retained earnings are those funds earned by the business for the owners, but which the owners have elected to leave in the business. Normally, such retained earnings are used in lieu of borrowed money to finance expansion. All proprietorship or equity funds are considered to be "permanent" investments or at least long-term investments, and are, therefore listed after the liabilities on the balance sheet.

The Income Statement

The income statement shows, as nearly as possible, the results of operations for an accounting period. All revenues earned and expenses incurred are indicated on this statement. The income statement is traditionally structured as shown in the following discussion and the accompanying sample statement.

REVENUE. The revenue section of the income statement comprises only the major source or sources of income. From these gross revenues, all product returns and sales cancellations and allowances are deducted. The resulting figure is called "net sales".

COST OF GOODS SOLD. This section of the income statement is used to determine the cost of goods used in generating the company's sales. The goods come from two immediate sources. One is the purchases made in the current accounting period, and the other is the goods left in inventory at the end of the preceding period. From the total dollar value of these two sources is deducted the cost of goods remaining in inventory at the end of this period. The resulting figure is the cost of goods sold, and this is deducted from "net sales" to determine the "gross profit," or profits earned before deducting operating expenses.

Sample Balance Sheet
(December 31, 20X3)

ASSETS			
Current Assets:			
Cash		$ 1,000	
Accounts receivable		2,000	
Stock in XYZ Company		10,000	
U.S. government bonds		4,000	
Inventory		5,000	$ 22,000
Intangible Assets:			
Patents		$ 3,000	
Copyrights		4,000	7,000
Fixed Assets:			
Land		$50,000	
Buildings	$100,000		
Less accumulated depreciation	30,000	70,000	
Equipment	$ 40,000		
Less accumulated depreciation	20,000	20,000	140,000
Total Assets			$169,000

LIABILITIES AND OWNERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 500	
Salaries and Wages payable	300	
Taxes payable	2,000	$ 2,800
Long-Term Liabilities:		
Long-term notes payable	$ 6,000	
Bonds payable	10,000	16,000
Total Liabilities		$ 18,800
Owners' Equity:		
Preferred stock	$ 20,000	
Common stock	100,000	
Retained earnings	30,200	150,200
Total Liabilities & Owners' Equity		$169,000

NET INCOME. To compute net income it is necessary to subtract the various operating expenses from gross income. These expenses can be divided into two types: (a) selling, and (b) general or administrative. Selling expenses include such items as salespersons' salaries, advertising expenses, and so on. General and administrative expenses include all other operating expenses not directly related to the selling of the product.

After deducting the operating expenses from gross income, the resulting figure is called *net income* (*or loss*) *from operations.* To this is added "other non-sales revenue" and from it is deducted "other non-sales related expenses." The categories "other income" and "other expenses" usually consist of bond interest earned or bond interest expense.

After accounting for the "other income and expenses," the figure remaining is *net income before taxes.* By deducting income taxes, the final *net income* figure is reached.

Sample Income Statement

(for the period ended December 31, 20X3)

Revenue from sales:			
Sales		$100,000	
Less: Sales returns and allowances		4,000	
Net sales			$96,000
Cost of goods sold:			
Beginning inventory	$20,000		
Purchases (net)	60,000	$80,000	
Less: Ending inventory		30,000	
Cost of goods sold			50,000
Gross profit on sales			$46,000
Operating Expenses:			
Selling expenses		$ 5,000	
General and administrative expenses		15,000	
Total Operating Expenses			20,000
Income or loss from operations			$26,000
Other Income		$2,000	
Less: Other expenses		500	1,500
Net income before taxes			$27,500
Federal (and state) income taxes			8,000
Net Income			$19,500

Interpreting Financial Statements

Financial statements are used by accountants, creditors, management personnel, and stockholders, among others, to determine the solvency and profitability of a business enterprise. To interpret the statements, ratio analysis is often used. While it is possible to use a great number of ratios, only seven of the most popular are given here. These are: (a) the current ratio, (b) the acid test ratio, (c) the inventory turnover rate, (d) the ratio of debt to equity, (e) the return on investment, (f) the percent of net income earned on sales, and (g) the percent of net income earned on assets.

The *current ratio* is the ratio of current assets to current liabilities. This ratio reveals the current liquidity of the firm, that is, the ability of the firm to pay off its current debts quickly.

Current assets

Current Liabilities

The *acid test ratio* is the ratio of current assets, less inventory, to total current liabilities. This ratio is identical to the current ratio with the exception that inventory is removed from the calculation. Theoretically, inventory is the least liquid of all current assets, and therefore a better measure of liquidity would be obtained if it were removed from the calculations.

$$\frac{\text{Current assets - inventory}}{\text{Current Liabilities}}$$

The *inventory turnover rate* reveals the number of times the entire inventory was "turned over" or sold during the period. It is computed by dividing the cost of goods sold by the average of the beginning and ending inventories.

$$\frac{\text{Cost of goods sold}}{\frac{\text{(Beginning inventory + ending inventory)}}{2}}$$

Perhaps the most important ratio of all, the *return on investment,* shows the amount earned on every dollar the owners have invested in the business. It is computed by dividing the net income by the average owners' equity.

$$\frac{\text{Net income}}{\text{Owners' equity}}$$

The percent of *net income earned on sales* reveals the amount of each dollar of sales that eventually becomes profit. This ratio is a good indicator of business efficiency. It is computed by dividing net income by net sales.

$$\frac{\text{Net income}}{\text{Net Sales}}$$

The percent of *net income earned on assets* reveals the profitability of investment in assets. This ratio is particularly helpful for businesses that require a heavy investment in plant and equipment. It is computed by dividing net income by average total assets.

$$\frac{\text{Net income}}{\text{Average Total assets}}$$

Measuring the working capital is also useful in interpreting the liquidity of a firm. Working capital is the excess of current assets over current liabilities. It indicates the safety margin in the "current" position of the firm.

Current assets - Current liabilities

Chapter 10 Review Questions

1. The balance sheet is a statement that is made up of all the following EXCEPT:

   A. Owner's equity

   B. Assets

   C. Liabilities

   D. Revenue

2. After deducting the operating expenses from the gross income in the income statement, the resulting figure is called:

   A. Revenue

   B. Cost of goods sold

   C. Net income or loss

   D. Other income or expenses

Chapter 11:

Business Statistics

Learning Objectives:

After studying this section you will be able to:

- Identify methods of data collection, and key business statistics.

The term *statistics* has several different meanings. In one sense, the word *statistics* refers to a collection of numbers that represent real objects; for example, the numbers found on a balance sheet or income statement. In another sense, statistics refers to the theory and method of analyzing those numbers in order to gain better information about their cause and meanings. The modern businessman relies on statistics to guide him in making rational decisions under the conditions of uncertainty he generally faces. Today these data are usually processed in such a manner as to be used in electronic data processing equipment.

Use of statistics in business involves four distinct but related steps: (1) the collection of data, (2) the analysis, summarization, and measurement of data, (3) the presentation of the data, and (4) the interpretation of the data for use in decision making.

Collection of Data

Data may be collected in various ways, depending on the nature of the population to be studied and of the problem. Some data may be ascertained simply by direct observation. Data involving human populations (which is the case in a large proportion of business situations) may be collected by the use of (1) mail surveys and questionnaires, (2) personal interviews, (3) telephone surveys, (4) panels of respondents, and (5) automatic recording devices.

The term *population* has a special meaning in statistics. It refers to the sum total of objects (inanimate objects or living beings) included in a particular group under study. Most populations are too large and complicated to be studied in their entirety. Statisticians therefore resort to a *sampling* technique-the isolation for analysis of parts of the population that are chosen as scientifically as possible to be representative of the whole. Obviously, the results can be no better than the sample.

Two basic types of data are used in solving statistical problems: primary data and secondary data. Primary data are those derived from a study (known as a primary study) designed specifically for the problem at hand. Secondary data are those obtained from secondary studies, that is, those already in published form or otherwise available and most likely gathered for some entirely different purpose. All data would, of course, at one time or another have been primary. The difference depends on the particular statistical problem involved-on whether the data were collected for this specific problem at this time or already existed in available form.

Secondary sources must, of course, be carefully evaluated as to their accuracy and applicability to the problem. Nonetheless, such data are widely used because they are readily available and are less costly to obtain. Secondary data are accessible in numerous governmental publications-public documents and reports, census publications, and standard reference sources such as the *Statistical Abstract of the United States, Survey of Current Business, and Federal Reserve Bulletin.* Non-governmental sources include numerous business newspapers, journals, and magazines; trade association publications; statistical source books; press releases; and many other sources.

Analysis, Summarization, and Measurement

Today, most statistical data are condensed on magnetic tape or other computer input devices. This gives the statistician quick and convenient access to them. To derive from any population the information that will be useful in decision making, however, it is necessary to go beyond the mass of raw data and apply to it the tools of statistical analysis. The *aggregate* or total number involved is sometimes significant. Determining the *proportion* of one element to the total or to other elements may be useful. Even more useful are *measures of central tendency,* or averages, which include the *arithmetic mean,* the *median,* and the *mode.*

In order to arrive at these three averages, it is necessary to arrange the collected data in the form of an *array*. An array is simply a listing, by size, of numeric data. From this, a *frequency distribution* is developed, which is simply a condensing of the array, noting the frequency with which each item in the array occurs.

The *mode* is the score in the frequency distribution that occurs most often. The *median* is the central, or middle, score in the array when arranged from lowest to highest or vice versa. The *mean,* or arithmetic average, is the total of all the values divided by the number of items in the array. The mean may turn out to be some value that did not even occur individually in the total sample. Similarly, the mode and the median may differ from the mean or from each other. Only in a perfectly balanced distribution will all three measures of central tendency be equal.

Populations are generally characterized by a considerable amount of variability or *dispersion*, which it frequently becomes useful to measure. The main measures of dispersion include (*a*) the range, (*b*) the quartile deviation, (*c*) the mean or average deviation, and (*d*) the standard deviation.

The *range* is simply the spread between the smallest and the largest item in an array. In arriving at the *quartile deviation,* the array is divided into four approximately equal groups called "quartiles." The *mean deviation* focuses on the average deviation of individual items from their arithmetic mean. The *standard deviation* is developed mathematically by a process involving squaring the deviations of individual items from their arithmetic mean. This makes the standard deviation easier to handle algebraically, and it is, in truth, the *standard* measure of dispersion.

Another commonly used statistical measure is the *index number*. Index numbers show the relative amount of change that has occurred among given items in a given period of time as compared with some base which is taken as 100. For example, an index number would be used to indicate the value of the dollar of today in terms of the 1949 dollar. Index numbers are useful because they make it possible to compare without distortion items from one time to another and one place to another. They have made it possible to construct such highly important indexes as the Wholesale Price Index and the Consumer Price Index of the U.S. Bureau of Labor Statistics.

Occasionally, it is useful to determine the relationship between two or more statistical items, as, for example, whether there is any dependency of one variable on another. The technique used to determine the degree of dependency is called *correlation analysis,* expressed in a coefficient of correlation. A correlation of 1.00 indicates a perfect relationship--when one item changes, the other changes in direct proportion in the same direction. A correlation of -1.00 indicates the reverse: as one item moves in one direction, the other moves in exactly the opposite direction. A correlation of 0.00 would, naturally, indicate no correlation; any similarity of movements between the variables would be strictly random.

Finally, it is useful to know how items of statistical importance have changed over time. One way this can be determined is by constructing a time series-a set of observations made at different periods of time. In constructing time series, it is usually desirable to show the data graphically. Such time series are of three types: those showing (*a*) secular trends, (*b*) cyclical trends, and (*c*) seasonal trends.

Secular trends are very long-term movements of a particular measure. Graphing the growth in gross domestic product (GDP) of the United States and the growth of population in the United States are examples of determining secular trends. Similarly, graphing the percent of the work force employed on farms over a period of years is determining a secular trend. Measurement of secular trends is useful in long-term forecasting.

Cyclical trends are swings or cycles that tend to recur at fairly regular intervals, usually over a period of several years. The stock market has its ups and downs every so often-usually at fairly regular intervals. This typifies a cyclical trend.

Seasonal trends are cycles that recur each year due to changes in the seasons. In most of the continental United States, the sale of snow tires follows a seasonal trend. This is also true for the sale of men's and women's sneakers, of swim suits, and even children's toys. Knowledge of seasonal trends is useful in short-run planning.

Presentation of Statistical Data

Statistical data may be presented and prepared for analysis in a number of ways. The first decision is whether to present the data in a table or a chart. More information can be given in a table and less work is required for the presentation. However, charts show comparisons more vividly. Charts may be of various types, including line charts, bar charts, circle or pie charts, pictographs, statistical maps, and scatter diagrams. In a line chart, a series of points is plotted on an arithmetic scale, and the points are connected with a line. Two or more items may be plotted on the same line chart. In bar charts, the bars, running horizontally or vertically, indicate the magnitude of various related items by the length of the bar.

Interpretation of Statistical Data

For statistical data to be useful in decision making, the most important requirement is that the data be interpreted correctly. This is the role of both the statistician and the business executive. Figures can be misleading-they can say whatever one wants them to say. Proper interpretation of these data, therefore, becomes of vital concern to all business executives, for without such interpretation, the process of decision making becomes that much more difficult.

Chapter 11 Review Questions

1. Primary data may be collected from the following sources:

A. Business newspapers

B. Journals

C. Designed studies using sampling techniques

D. Standard references

2. A frequency distribution that gives the score in the frequency distribution that occurs most often is the:

A. Median

B. Mode

C. Mean

D. Range

Chapter 12:

Business Finance

Learning Objectives:

After studying this section you will be able to:

- Recognize factors of a financial plan and sources of financing.

Business finance is concerned with (1) *providing* the funds an enterprise needs, and (2) determining the most effective *use* of these funds within the business in order to attain its objectives. Business is continually faced with the problem of acquiring money to pay current bills, to replace worn-out equipment, and to provide for expansion. The financial manager realizes that it is his job to get the needed funds on the best terms possible. He must, therefore, be prepared to choose from among alternative sources of funds those best suited to the firm's requirements.

At the same time, however, the finance function is broader than just acquiring funds to pay bills and support current programs. It also includes the allocation of the funds within the business firm. The financial manager is involved in such decisions as what new projects should be undertaken and how the money should be allocated to these projects; whether to pay a dividend on common stock and how much to pay; temporary investment of any surplus funds; and projecting future needs for funds. In fact, the financial function is reflected in almost every aspect of a business.

Funds that are required by a business can be separated into two categories: (1) those intended to finance the long-term, or fixed assets of the firm, and (2) those funds intended to finance the current assets of the firm. Because these two categories differ so much in the purpose for which the funds are to be put, it is common practice to associate long-term capital with the financing of long-term assets, and to utilize short-term sources of funds to acquire short-term assets. The logic behind this can be seen in the case of a building. It would be foolish to buy a building intended for use over a 20-year period with a note that comes due in 90 days. It would be much more logical to pay for the building over the entire 20-year period of its use. In that way, profits earned by using the building can help pay for the cost of the building.

There are basically three ways of financing business activity: (1) through the use of funds supplied by the owners of the business, (2) by utilizing funds that have been earned through operations and retained in the business, and (3) by using credit, that is, using borrowed money.

In any business finance situation, several factors must be considered before a decision on financing can be reached. These factors include: (*a*) determining who will bear the burden of the cost and repayment of loans, if any; (*b*) the effect on business control; (*c*) the flexibility of the plan; (*d*) market conditions; and (*e*) the expected level of earnings of the firm. Each of these factors must be considered whenever a firm seeks financing; whether it be short-term financing or long-term financing.

Short-Term Financing

All business firms are faced with the problem of obtaining financing for the day-to-day operations of the business. Also, some businesses find it advantageous to make use of short-term funds for one of the following reasons: (*a*) They may have seasonal demands that require a temporary source of funds. For example, a toy manufacturer may need financing in the fall to pay for raw materials that go into the toys he makes. These funds can then be repaid in the winter when the Christmas sales' revenues come in. (*b*) A business may use short-term financing to obtain an established credit rating. Many firms find it difficult to obtain intermediate and long-term loans because they have not established a good credit rating with suppliers of short-term funds. (*c*) Businesses may use short-term financing in lieu of long-term financing or intermediate-term financing, especially when interest rates are very high and are expected to go down. For example, a firm that needs to finance a new piece of equipment when interest rates were high-and then to refinance it later when interest rates were expected to be lower.

Sources of short-term funds include the following: (1) normal trade credit, (2) bank credit, (3) borrowing from private sources or financial institutions on the basis of promissory notes, (4) sale of commercial paper, (5) factoring of accounts, (6) use of drafts, (7) trade acceptances, (8) issuance of chattel mortgages, and acquiring collateral that may be used to secure loans through (9) bills of lading and (10) warehouse receipts.

Trade credit is financing provided by suppliers, who ship merchandise with billing terms calling for payment at some future date. In the meantime, the purchaser has both the merchandise and the money. Since he does not have to pay immediately, the purchaser has, in effect, been granted a short-term loan. Trade credit is the most important source of short-term financing.

Bank credit is the second most important source of short-term funds. Such credit may take the form of a standard *bank loan*, in which the firm agrees to repay its debt at some predetermined time; or it may take the form of a *line of credit* . A line of credit exists when a bank has approved-in advance-loans to a customer up to a certain maximum amount. Lines of credit are often used by businesses to pay for merchandise, once the trade credit terms have expired.

Use of *promissory notes* to secure short-term loans from private sources or banks is common, particularly among partnerships and sole proprietorships. The promissory note is merely a promise to pay, usually unsecured other than by the good faith of the maker.

For certain firms having strong credit standing, the sale of *commercial paper* is a source of short-term funds. These are essentially promissory notes. The denominations are usually large and the paper is unsecured other than by the reputation of the company.

In some industries, such as the furniture industry, sales are made on credit terms that call for payment over a long period of time. Often, the seller of the merchandise cannot afford to wait that long for the full proceeds of the sale. In such instances, it is common for the merchant to "sell" the account receivable to a collection agency. This collection agency is known as a *factor*. The factor pays the merchant something less than full value for the receivable, and proceeds to collect it himself.

Short-term funds may be obtained by the use of *drafts.* A draft is similar to a promissory note, except that it is an order to pay, not a promise to pay. Three parties are involved: one party instructs the second party (usually a bank) to pay a third party a specified sum at a certain time.

A *trade acceptance* is similar to a draft except that it is drawn by the seller, not the buyer, and is mailed to the buyer. The buyer then "accepts" the order to pay, and then it becomes, in effect, another draft.

A *chattel mortgage* is, basically, a mortgage on movable property. It is popular in railroad financing and in some other specialized fields.

A *bill of lading* is a receipt issued by a transportation company signifying title to goods in transit. Such certificates of title can be used as collateral for a loan.

A *warehouse receipt* is a title issued by a warehouse holding merchandise for a company. This receipt can then be used as collateral for a loan since the possessor can legally take title to the goods in the warehouse.

Long-Term Financing

Long-term financing generally is used for financing the acquisition of fixed assets, intangible assets, and permanent investments. Usually, long-term financing refers to a period of time in excess of 10 years, whereas short-term financing refers to monies needed for less than 1 year. Financing for the period of 1 year to 10 years is considered intermediate-term financing.

There are basically three sources of long-term capital: (1) debt financing, (2) new owners' funds and (3) internally generated sources of funds. The source or sources chosen for any particular long-term financing venture are determined by a number of considerations, such as (1) the availability and cost of such financing, (2) the stability of the organization itself, (3) the general conditions in the economy at the time the financing is undertaken, and (4) federal tax regulations. Often, these considerations are the result of factors beyond the control of the financial manager. As a result, his efforts are often concentrated on the characteristics of the source of funds being used, namely the characteristics of debt, equity, and internal financing.

Debt Financing. The most common form of debt financing is through issuing bonds. In doing so, several considerations must be kept in mind: (*a*) Since the loan is only for a specified period, at some future date the debt must be repaid. (*b*) Because of the size of the probable bond issue, the way in which the bonds are retired is important. Considerations of such things as a serial retirement plan (in which bonds are retired or paid off according to a serial number printed on each bond), or sinking fund retirement plan, must be made. (*c*) As with any debt financing, the use of bonds means the payment of periodic interest. This interest *must* be paid-default can endanger the owners' control of the business.

There are many different types of bond issues, but the following are among the most common: (1) debentures, (2) coupon books, (3) registered bonds, (4) income bonds, (5) convertible bonds, (6) equipment trust bonds, and (7) mortgage bonds.

Debenture bonds are unsecured obligations promising to pay a specific amount of money (the principal) at a stated date in the future, and to pay interest on this principal at specified intervals over the life of the bond. As with all bonds, the indenture agreement (the terms of the bond issue) is directed to a trustee who represents the bondholders in the agreement with the company. The use of a trustee is, therefore, one of the characteristics that distinguishes bonds from other debt instruments.

Coupon bonds are bonds payable to *bearer* on a specified date. Unlike other bonds, the issuing company has no record of each bondholder's identity. Interest is paid on presentation of a "coupon" that was attached to the bond.

Registered bonds have the owner's name typed directly on the bond, thus serving as identification and affording the bondholder some protection against loss if the certificate becomes misplaced or stolen.

Income bonds usually are unique in that they offer no interest unless and until income is earned by the company. These bonds are rarely seen any more.

Convertible bonds are distinguishable by the right of the bondholders to exchange the bond for other securities-usually common or preferred stock.

Equipment trust certificates are bonds which carry with them title to major capital equipment. The title serves as security, or collateral, in the event of default.

Mortgage bonds, like equipment trust certificates, are collateral bonds; the collateral being a mortgage on property of the issuing company.

OTHER CONSIDERATIONS. As indicated, debt financing has the rather obvious disadvantage of having to be repaid. There are three popular ways of handling the retirement of bonds: (1) a call option, (2) a sinking fund, and (3) the serial plan.

The *call option* is a clause in the indenture agreement giving the issuing company the right to call in, or retire, bonds in advance of the stated maturity date. The option usually requires that the company pay a premium for this privilege.

The traditional *sinking fund* consists of the steady and systematic accumulation of cash which, at the appropriate time, is used to pay off the outstanding bonds. Modern sinking fund arrangements allow the sinking fund trustee to use the periodic payments into the sinking fund to purchase the bonds in the open market and retire them. It works almost like the serial plan described below.

The *serial plan* requires that all of the outstanding bonds carry a serial number indicating the order in which the bonds were issued. This number then serves as the indicated order of retirement; those bonds issued first are the first retired, and so on.

Owners' Funds. Corporate financing providing new funds from owners is of two types. The company may issue preferred stock or it may issue common stock. The types differ in their legal status and in the terms underlying their issue.

PREFERRED STOCK. Preferred stock is a form of equity financing that very much resembles a bond issue. Like a bond, preferred stock carries a stipulated and usually fixed rate of return (the preferred dividend). Preferred stock is entitled to receive its dividend before the common stockholders, and in the event of dissolution may have priority to the assets of the firm over the common stockholders. Like common stock, preferred stock may also carry the right to vote. Preferred stock may be:

1. Cumulative or noncumulative: If it is cumulative, any dividends not paid in a given year must be paid in full in succeeding years before any dividends can be paid to common stockholders.
2. Participating: Preferred stock that is participating is allowed to receive additional dividends according to a preset formula. In other words, the dividend has a variable ceiling, depending on the amount of total dividends declared.
3. Convertible: Convertible preferred stock may be exchanged for common stock in the same company at a specified exchange rate.

COMMON STOCK. Common stock represents the residual ownership in the corporation. This is the voting stock, and it carries with it residual claims on profits and assets of the firm. It has no guaranteed dividend, cannot be converted into any other security, cannot be recalled for redemption, and is not entitled to any specific assets on dissolution of the firm. Once issued, it can only be reacquired by the company with the consent of the stockholder. This is the most popular security of all.

INTERNAL SOURCES. These sources include funds earned and retained by the company.

Conclusion

The factors affecting the choices of long-term financing are many and complex. Sometimes the choice of a particular method of financing is made because of seemingly unavoidable situations. For example, a firm may use stock because it is difficult to obtain a loan. When several sources are available, profitability influences the answer. Many financial managers try to successfully "trade on the equity"' that is, borrow money at a rate of interest lower than the expected rate of return from prospective investments. The profits that are thus earned in excess of the cost of borrowing the funds can then accrue to the stockholders-thereby increasing their return.

Chapter 12 Review Questions

1. Short-term funds can include:

   A. Debt financing

   B. New owner's funds

   C. Trade credit

   D. Internally generated sources

2. A clause in the indenture agreement giving the issuing company the right to call in or retire bonds in advance of the stated maturity date is the:

   A. Call option

   B. Sinking fund

   C. Serial plan

   D. Owner's stock

Chapter 13:

Managerial Control

Learning Objectives:

After studying this section you will be able to:

- Identify sales and production planning techniques.

Managerial control can be thought of as comprising three basic elements: (1) the establishment of standards, (2) the measurement of performance, and (3) the analysis and correction of variations from the expected or forecasted results.

For a business firm to compete successfully in today's world, its management must be highly efficient in (*a*) controlling expenses, (*b*) selling its product or service, and (*c*) anticipating changes in economic conditions or consumer demand that may influence the costs and sales of the company. The function of management referred to as *controlling* is basically concerned with these two problems: controlling product-cost relationships within the firm and anticipating product-cost influences external to the firm.

Forecasting

Good forecasts, especially accurate sales forecasts, are essential to planning and control. Forecasting may start with estimates of overall economic activity for some future period. Often, gross national product is used as a measure by economists in order to project future trends. Then, the sales within a particular industry may be forecasted. How much of any forecasted growth or decline will be reflected in a particular industry? Finally, and most important for planning and control, the sales forecast for the particular company will be prepared.

The company sales forecast will make it possible to set standards for accomplishment without which it would be virtually impossible to evaluate performance. It will form the basis for developing a budget. It will affect many other aspects of the business-production schedules and control, inventory control, salary and wage administration, capital investment and budgeting, and flow of cash expenditures. In fact, there are few, if any, phases of a business that will not be affected by the sales forecast.

Forecasts may be short term-for one year or less-or long term-for two or more years. For purposes of ordinary planning and control, the short-term and long-term forecasts are calculated and developed in similar ways.

The methods employed by business in making a sales forecast vary from business to business. Some firms rely on the best judgments-or guesses-of the firm's executive officers to develop a sales forecast. Such a method is commonly referred to as a "jury-of-executive-opinion" method, and while it is not very scientific, it is widely used among smaller companies.

Other firms may rely on feedback from the sales force as to prospects for the future. Although sales persons are often a good source of such information, care must be taken when considering such feedback; sales persons are apt to misstate prospects for their territory, possibly in anticipation of gaining bonuses and other incentives companies often award to sales persons who exceed quotas for their territories.

Still other companies may rely on more scientific methods, notably, (*a*) time-series projections (a statistical method of forecasting by projecting the seasonal, cyclical, and growth factors that influenced a company's sales in the past), (*b*) a "least-squares" method of projection (a statistical technique that uses simple regression analysis for projecting past sales performance into the future), and (*c*) simulation models (computerized models that duplicate actual conditions as much as possible and then show the change that can be expected to occur given changes in sales expectations). Although these give highly detailed forecasts, it should be noted that the forecast itself can be no more accurate than the assumptions that underlie it.

Once a sales forecast has been developed, it is customarily used as a basis for the standards of operation throughout the firm. Salesmen are given quotas to meet-quotas that are based on the forecast and told to maintain certain minimum inventory levels and wage and salary expense constraints. The purchasing agent is expected to obtain the necessary raw materials and other supplies to keep the production of the goods flowing in an orderly manner. The financial manager is given the forecast so that she may properly plan the flow of funds through the firm. She is expected to plan so that the firm will always have sufficient cash on hand to meet all bills, support current programs, and lay the groundwork for future expansion. The establishment of standards such as these is crucial to the successful control of the operations of the business enterprise.

Once the standards have been established, management then compares the performance of each department against the standard. In many cases, control operates through the "exception principle," which means that management only examines those departments or areas where significant variations from the standard appear. In some cases, the standard proves to be at fault. This is usually the case when the forecast was based on erroneous assumptions. In other instances, the deviation reveals certain problems in a particular department.

After uncovering the unfavorable deviations from the expected standard, management goes about resolving the problem. The problem becomes particularly acute if it involves an erroneous forecast, since a faulty forecast may result in wide deviations in several departments later on, with resulting serious financial implications.

Budgeting

One of the most important results of a sales forecast is the development of a cash budget and a capital budget. The cash budget is a statement showing expected cash inflows (receipts) and expected cash outflows (expenditures). The difference between the inflows and outflows each month or each period represents either (*a*) the cash surplus for that period-in the event inflows exceed outflows, or (*b*) the cash deficit for the period-should outflows exceed inflows. This is an important budget for the financial manager, since he must know when he will be in need of external financing and when he will have a surplus that should be invested.

Similarly, the capital budget is a budget or plan of expected outlays for capital equipment. if the sales forecast shows an expected increase in sales, this may encourage the management to decide to replace old equipment or acquire additional capacity. In either case, management must know the exact state of the capital equipment in the firm so that better decisions can be made. It might appear that the items indicated for the capital budget should really be found in the cash budget. But the importance of capital investment decisions to the general welfare of the firm is so great that most managements prefer to deal with these decisions separately.

Other Control Techniques

Management has several quantitative techniques that it uses to control operations. One of these is a break-even analysis, mentioned previously. A business incurs two types of expenses: fixed and variable. Fixed expenses are those that remain relatively constant regardless of the level of output. Even if the firm had zero production and sales, these expenses would be incurred. Variable expenses are those whose total amount varies with the level of output of the firm. If no output is forthcoming, these expenses are non-existent. If the firm is operating at full capacity, these expenses may account for the largest portion of the cost of production. Management is concerned with the level of output that is necessary in order for the firm to meet both the fixed and the variable expenses. That level is the break-even point. Management is even more concerned about expenditure decisions that will influence this break-even point. When combined with an accurate sales forecast, the two provide management with a good insight as to profit prospects of the firm.

Still other quantitative techniques involve EOQ or economic order quantity (a technique for minimizing the total investment in inventory while maintaining an adequate level of inventory to meet a given level of expected orders. Use of EOQ will help a firm avoid both excessive investment in inventory and "stock-outs" that reduce sales. Linear programming is a computerized technique that allows a firm to determine the optimum levels of output for several product lines at the same time. If a firm can produce only X number of units of good A and Y number of units of good B, a linear programming technique will tell the manager what proportions of goods A and B he should produce in order to maximize profits.

Forecasting, budgeting, break-even analysis, economic order quantity, and linear programming are only a few of the many tools available to management in their efforts to control their businesses. In today's world, such control is a prime factor in determining which companies will remain competitive and which will disappear from the American economic system.

Chapter 13 Review Questions

1. One of the basic elements of managerial control is:

A. Time-series projection

B. Least-square methods

C. Measure of performance

D. Simulation model

2. One of the most important results of a sales forecast is the development of the:

A. Cash outflows (expenditures)

B. Cash budget

C. Cash inflows (receipts)

D. Cash surplus

Chapter 14:

Financial Institutions

Learning Objectives:

After studying this section you will be able to:

- Recognize the scope of the Federal Reserve System in banking practices.

Financial institutions are businesses that assist consumers, other businesses, and government by channeling funds from those who have excess (called *savings*) to those that have deficits (called *loans*) in their available funds. Such institutions may be examined in many ways, although the most common way is to distinguish them either by (a) the type of user or supplier of funds they assist, (b) the typical length of maturities of the financial instruments they handle, or (c) the nature of the market they serve, i.e. primary or secondary markets.

Viewed in their totality, financial institutions are guided in their policies, for the most part, by the activities of two major institutions, one public and the other quasi-public. These are the U.S. Treasury and the Federal Reserve System. The U.S. Treasury affects other financial institutions because its function concerns (a) the management of the national debt, and (b) the management of the nation's money supply.

Similarly, the Federal Reserve System is a quasi-public institution designed to facilitate the orderly growth of our economy and the maintenance of stable prices. Established in 1913, the Fed, as it is known, is comprised of 12 regional banks, the management of which consists of persons appointed by the local banks that are members of the System, and by appointees of the Board of Governors of the Federal Reserve System. The Board, in turn, is appointed by the President of the United States, and is comprised of seven members. Basically, the Fed operates as a "banker's bank," providing member banks with currency, clearing checks for them, and granting loans to member banks when conditions so warrant. At the same time, the Fed acts as an agent for the U.S. Treasury, assisting primarily in the orderly disposition of the large number of government securities that are sold and redeemed daily in the open market.

Although not all banks are required to belong to the Federal Reserve System, and, in fact, most of them do not, most of the large banks belong to the system. And since they account for most of the banking business transacted in the United States, the Fed exercises considerable influence over banking practices in this country. This influence is exercised primarily through the judicious use of three controls: (a) the open-market operations, (b) the reserve requirements, and 9c) the discount rate. Through the open-market operations, the Fed can regulate the supply of money member banks have available for loans. It can require member banks to use the funds to purchase additional government bonds, or it can purchase government bonds from the banks, thereby freeing funds for loans to industry and consumers. By changing the reserve requirements, the Fed can also affect the loan position of member banks. An increase in the reserve requirement reduces a bank's ability to loan funds, and a decrease in the requirement increases a bank's supply of free funds. Similarly, the discount rate dictates the interest rate the Fed will charge member banks for loans. The higher the rate, the less attractive it is for local banks to borrow from the Fed.

Specific Financial Institutions

Commercial Banks. By far the most important financial institution in this country is the commercial bank. Numbering well over 10,000 in total, commercial banks are one of the primary sources of short - term funds for business. Furthermore, they hold most of the outstanding governmental debt issues, both for the federal government and for state and local governments. Commercial banks are also a major source of funds for financing mortgages and consumer loans. Their savings departments aid in the accumulation of these funds.

Much of the lending power of commercial banks stems from the fractional reserve system in operation for these institutions. This system allows commercial banks to keep only a "fraction" of their total deposits on reserve as backing for potential withdrawals. The remainder of the deposits can be loaned out, thereby creating deposits in other banks throughout the country.

Savings and Loan Associations. Savings and loan associations operate in much the same manner as commercial banks, except that the bulk of their loans (and, therefore, their major contribution as a financial institution) goes to the financing of mortgages on real estate. The savings and loan associations have been a vital source of funds for the construction industry in this country, and today rank among the largest financial institutions in the country.

Mutual Savings Banks. Mutual savings banks are not a significant factor in the total picture of financial institutions but are worth noting, since they represent a cross between the savings and loan associations and the commercial bank. Owned by the depositors, rather than by stockholders, mutual savings banks are located, for the most part, in the eastern United States. The bulk of their loans goes to financing of real estate mortgages, much as with savings and loan associations. The only significant difference is that the mortgages financed by mutual savings banks are usually commercial mortgages, whereas savings and loan associations finance a large number of residential mortgages.

Life Insurance Companies. The second largest financial institution is the life insurance company. The source of funds for this institution is the premiums paid in by policyholders of life insurance. To provide the funds necessary to meet future claims on these policies, the insurance companies invest this money in securities and loans. The most significant differences between the life insurance companies and the commercial banks lie in the type and degree of governmental regulation, and in the length of maturities in which each can invest. Commercial banks are forced to consider the liquidity of their investments; they never know when they may be called on to increase liquidity or to return to depositors large sums of their deposits. Life insurance companies, on the other hand, know that the policies they have written will come due according to predictable statistics found in the mortality tables. Accordingly, they are free to invest their funds for very long periods of time. Consequently, most life insurance funds are tied up in long-term business obligations (bonds), real estate mortgages, and government bonds. A much smaller portion of their assets is invested in short-term loans.

Pension Funds. One of the fastest growing financial institutions is the corporate pension fund. These funds are competing with insurance companies for long-term investments. However, because they are relatively free from regulation, they have been concentrating their investments to a large extent on common stocks. Pension funds, like insurance companies, can determine with some precision just when they will need to have money to pay individual pensions, and can, therefore, sacrifice liquidity for profitability resulting from their long-term investments.

Finance Companies. Finance companies are of several types, each of which has a rather specialized role in the total area of finance. *Factors* are finance companies specializing in the collection of accounts receivables from a company, thereby providing funds to the business. They, in turn, collect these receivables from the customers. *Commercial finance companies* provide loans to businesses, usually after receiving some form of collateral from the business. Because these finance companies usually deal with relatively high-risk borrowers, they tend to charge relatively high rates of interest for the use of their funds. Similarly, *consumer finance companies* usually assist consumers in obtaining short-term funds. Often, such finance companies obtain large bank loans on their own credit, and then re-loan this money to more risky clients at high rates of interest. Similarly, *sales finance companies* usually obtain installment sales contracts from retailers, and then provide the collection facility.

Credit Unions. Credit unions are financial institutions that cater to a select group of individuals. Members of credit unions must first make deposits in the union, and then may utilize the union to borrow funds at relatively low rates of interest. Credit unions are usually associated with places of employment or with fraternal associations.

Personal Trust Departments. Personal trust departments of banks differ from other financial institutions in that they do not provide funds, per se, but rather provide professional management of investments for individuals. Depending on the nature of their agreement with the person whose funds they are managing, the nature of their investments will differ.

Investment Companies. Investment companies are similar to trust departments in that they, too, do not provide funds per se but rather provide management of funds. In the case of investment companies, this management is concerned with investments in stocks and bonds. The two most commonly known investment companies are the closed-end companies and the open-end companies, otherwise known as mutual funds. Through these institutions, the average individual is able to invest his capital in markets not otherwise available to him.

Primary Market Activities

For the most part, investments made by the aforementioned institutions in the securities markets are made in the secondary market; that is, they buy and sell securities that had previously been purchased by others. On occasion, several of these institutions will deal in the primary markets, and when they do, they usually rely on the services of an investment banker.

Investment Banking. The investment banker is a financial expert who assists corporations in determining the type, size, and amount of securities they will issue in their quest for capital. The investment banker (or a syndicate of investment bankers) after providing counsel, may decide to "underwrite" the issue, meaning that he will buy the securities at a fixed price from the corporation. Through his knowledge of the financial markets, he can then resell the securities to other institutions, making profit himself if he is successful, and taking a loss if he is not. On occasion, the investment banker may know in advance of potential institutions that are interested in certain types of securities and can arrange a private placement-that is, a sale of the securities directly from the corporation to the institution. For this service he also receives a fee. Investment bankers are described further in the next chapter.

Chapter 14 Review Questions

1. The two major institutions that guide financial institutions in setting their policies are the US treasury and:

A. Banks

B. Savings and loan associations

C. Life insurance companies

D. The Federal Reserve System

2. An example of a primary investment investor expert that provides the management of funds is

A. Investment banker

B. Commercial banks

C. Savings and loans associations

D. Mutual savings banks

Chapter 15:

The Financial Markets

Learning Objectives:

After studying this section you will be able to:

- Identify different stock exchanges, indexes and security market regulation.

When a corporation is first formed, or when its financial manager decides that additional long-term financing is desirable, the company's management usually calls on a specialist for advice on the type of securities the company should issue, the probable price that these securities should carry, and other conditions related to the issue. Such a specialist, known as an *investment banker*, was discussed in Chapter 14. As stated there, the investment banker specializes in advising corporations on the best form of long-term financing available to them, assists in finding buyers for the securities, and even may provide temporary financing while the securities are being sold.

Frequently, a group of investment bankers will join together in a *syndicate*, an investment banking group formed for a specific, short-term project. If the investment banker decides the firm's securities can be sold to prospective buyers without undue difficulty, it may underwrite the issue, that is, pay the issuing company the full value of the securities being issued, thereby assuming full responsibility for their sale. The underwriting agreement amounts to a guarantee of the sale of the securities. The securities thus acquired by the investment banker are then resold to prospective buyers at a slightly higher price than the underwriter promised the company. The difference, or spread, between the price guaranteed the issuing company and the eventual proceeds from the sale of the securities to others, is the investment banker's profit.

Once securities have been issued and are in the possession of investors, they become "used" securities. Such securities are to be distinguished from "new" securities in that new securities are securities being sold for the first time. Securities may be sold and purchased on organized security exchanges or on other semi regulated securities markets.

The securities markets are those places where buyers and sellers of corporate and government securities are brought together to affect their business. The securities markets can be divided into (*a)* the stock market, (*b)* the bond market, and (*c)* the commodities market.

The Stock Market

The market for equities, or common and preferred stocks, can be found both on organized stock exchanges and in the less-regulated, more informal market known as the "over-the-counter" market. While most stocks are traded "over-the-counter," the stocks of most of the largest companies are listed on various stock exchanges; indeed, most of the trading in stocks occurs on the organized exchanges.

The oldest, largest, and best known of all the stock exchanges is the New York Stock Exchange, otherwise referred to as the "Big Board." About 85 percent of all activity on organized exchanges occurs on the New York Stock Exchange, although other exchanges do exist and render important and useful services to businesses around the country. Among these other exchanges, the best known are the American Stock Exchange, also located in New York, and the Midwest Stock Exchange, located in Chicago.

The New York Stock Exchange, like the other stock exchanges located around the country, is organized along the lines of a private club. Memberships are sold to individuals, and occasionally businesses, that give these people the privilege of assisting buyers and sellers in the trading of securities. For their service, the members receive a commission on all trades they handle. Naturally, the value of these seats, or memberships, rises and falls with the volume of business transacted. Seats on the exchanges have sold for as high as several million dollars.

When individual desire to buy or sell stock, they must contact a broker or securities dealer, who then handles their transaction for them. Brokers are merely agents acting on behalf of their customers in the buying-selling process. When they receive a customer's instructions, they contact a member of the exchange who then executes the desired transaction at the specific "trading post" set up for the particular stock in question. At the trading post is an exchange employee known as a specialist. The specialist is responsible for handling all buy and sell orders in a particular stock, or, on occasion, in a select few stocks. His job is to match buyer with seller, acting as either a buyer or a seller himself if no other can be found. In this way, a market is always available to anyone wishing to buy or sell any given stock. Because the market operates on an auction basis, the specialist has the power to raise or lower the price in order to facilitate matching buyer and seller. Once a transaction is completed, a report of it is sent via ticker tape to brokerage houses all over the country, thereby informing them of the latest price at which the stock was sold.

To assist in executing trades economically and swiftly, the specialist will only handle "round lots" of stock. These are usually blocks of 100 shares each. All trades of less than a round lot, or for "odd lots," as they are referred to, are handled at special odd-lot trading posts.

The entire transaction, from the moment the customer contacts the broker to the time the broker is notified of the price at which the sale or purchase was made, usually takes but a few minutes. For the service, the broker charges the customer a fee, known as the commission. This commission is usually dependent upon the market value of the transaction, going up at a decreasing rate as the market value of the transaction increases. For trades executed in New York, a state transfer tax is also assessed to all sales.

Securities traded “over-the-counter” are handled in much the same manner. Instead of specialist, however, a particular brokerage firm may decide to "keep a market" in a given stock. When customers desire to purchase or sell that stock, their broker calls the firm "making a market" in the stock to inquire as to the price. The broker is then given a "bid" price and an "ask" price on the stock. The "ask" price indicates the price at which the stock may be sold. The spread between the two prices is the profit charged by the firm "making the market."

Each day the nation's newspapers and financial press publish a review of the preceding day's stock transactions as they occurred on the major exchanges. These summaries usually appear as shown below where (*a*) and (*b*) indicate the high and low prices for the preceding 52 weeks, (*c*) indicates the name of the company, (*d*) is the latest indicated annual dividend rate, (*e*) is the yield, or rate of return for potential investors (calculated by dividing the annual dividend by the current market price), (*f*) reflects the number of times the market price of the stock exceeds the company's earnings per share, (*g*) is the sales excepted for that day, in hundreds of shares, (*h*) is the highest price reached during the day,(*I*) is the lowest price reached during the day,(*j*) is the closing price for the day and (*k*) is the net change from the preceding day's closing price.

52 wks					P-E	Sales				Net
High	Low	Stock	Div.	Yield	Ratio	(hds)	High	Low	Close	Chg.
67¾	49⅛	Exxon	4.80	7.9	6	2869	61¾	60¾	60¾	−¾
(*a*)	(*b*)	(*c*)	(*d*)	(*e*)	(*f*)	(*g*)	(*h*)	(*i*)	(*j*)	(*k*)

Analysts of stock prices have noted that certain groups of stocks tend to rise in price or fall in price in accordance with the overall directions of all stock prices. Accordingly, stock "averages" have been established to reflect the general condition of the market. Among the popular averages are (*a*) the Dow Jones Average, developed by Charles H. Dow in the 1800's and today is still the most popular of the averages; (*b*) the Standard and Poor's Index, similar to the Dow Jones but encompassing many more stock issues;(*c*) the Russell Index; and (*d)* the New York Stock Exchange Index of average price changes. All of these averages reflect broad changes and claim some reliability at signaling changes from a "bull" market (a rising market) to a "bear" market (a falling market) or vice versa.

The Bond Market

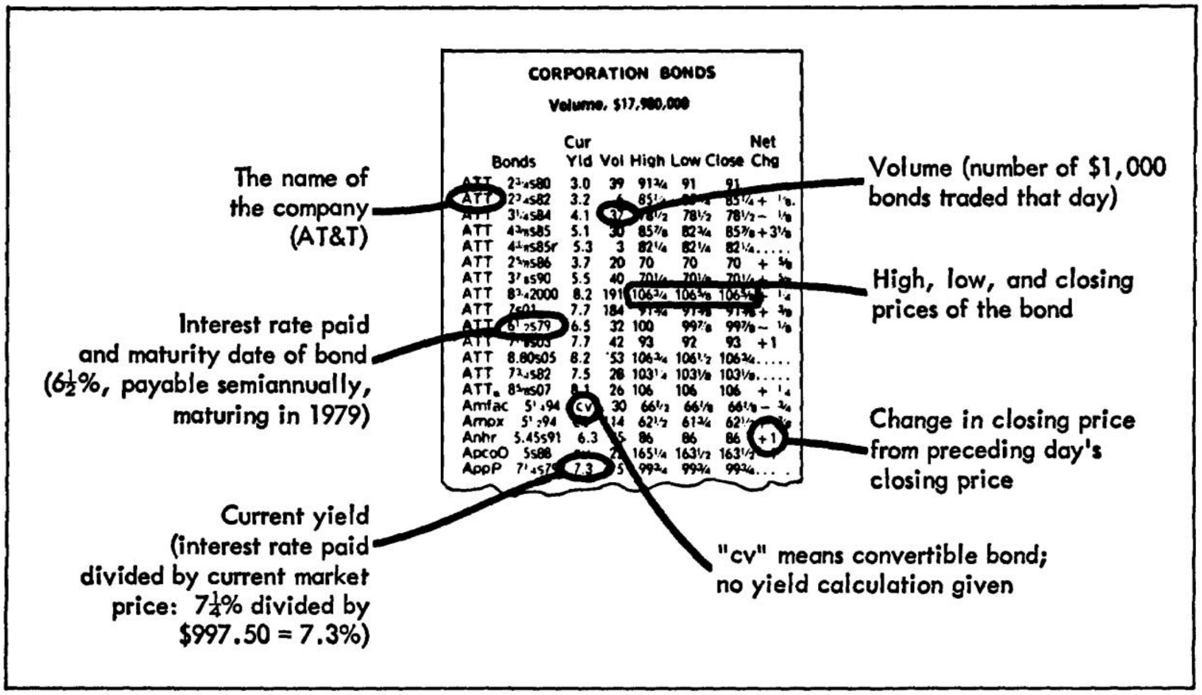
Bonds, too, are traded on the New York Exchange and other organized exchanges. However, much of the trading in bonds takes place on the over-the-counter market. Bonds, while traded much like stocks, have the following unique characteristics: (*a*)they are usually sold in $1,000 denominations, or variations thereof; (*b*) they may be sold at a premium (a price above par) or at a discount (a price below par), depending on the investment quality of the security and the rate of interest offered; (*c*) bond prices are usually quoted in thirty-seconds of a point if they are government issues, or eighths of a point if they are corporate issues; and (*d*) bond prices are directly affected by changes in market interest rates.

The Commodities Market

The commodity markets are the markets in which grains, feeds, livestock, foods, fibers, metals, etc., are bought and sold. The basic markets exist in commodity trading. One of these is the *spot*, or cash market. The other is the futures market. The spot market is used primarily by suppliers and users of the actual commodities in question. Farmers use the spot market when selling grains, and baking firms (like Pillsbury) use the spot market for buying the grain that is eventually turned into flour.

In contrast, the futures market involves the purchase and/or sale of contracts calling for delivery at some date in the future. Most investors, or speculators, trade in the futures market. This is because it is not necessary to actually trade or make delivery of the commodity. To avoid the delivery phase of the contract, all one needs do is dispose of the contract before maturity.

Reading the Bond Pages



Security Market Regulation

The securities markets come under close supervision by federal and state authorities. This, however, was not always the case. Prior to 1909, "*caveat emptor,*" meaning "let the buyer beware," prevailed. In 1909, however, the federal government outlawed the use of the mails for purposes of fraud. In 1911, Kansas became the first of the states to pass the "blue-sky" laws; laws which regulated security issues and their promoters within the borders of a given state. Further legislation was forthcoming after the stock market crash of 1929; in 1933, the Federal Securities Act was passed. This law required registration of issues with the Securities and Exchange Commission, and required the issuance of a prospectus for new issues. In 1934, the Securities Exchange Act was passed, regulating the major stock exchanges and imposing rules for margin trading. As a result of these laws, individuals are able to invest in securities today, more confident than before, that full disclosure has been made concerning the stocks they are acquiring.

Chapter 15 Review Questions

1. A group of investment bankers that have joined together in a short-term project is known as:

   A. New York Stock Exchange

   B. American Stock Exchange

   C. Syndicate

   D. Mid-West Stock Exchange

2. Commodities are classified as all the following EXCEPT:

   A. Grains

   B. Livestock

   C. Bonds

   D. Metals

Chapter 16:

Risk and Insurance

Learning Objectives:

After studying this section you will be able to:

- Identify elements of risk and insurance policies.

The very nature of business activity dictates that decisions must be made regarding future events. In making these decisions, business firms face risk and uncertainty. The types of risks a business faces can be classified as pure risks and speculative risks. Pure risks are those that can only result in financial loss. Speculative risks are those that can result in either loss or profit. The risk of fire, theft, and customer injury can only lead to financial loss. These are example of pure risk. Risks regarding changing consumer preferences, new product research, and so on, are considered speculative risks, since the final outcome could conceivably benefit the company taking the risk.

Business firms can accept speculative risks or reject them, depending on the degree of confidence placed in management. The pure risks, however, are a different problem. Business people are inclined to reject or refuse to make decisions concerning situations in which there is a strong probability of financial loss. For this reason, business people seek ways of avoiding risk.

There are basically four ways business people can handle the problem of risk: (*a*) They can eliminate the particular hazard. For example, the risk of getting hit by a car can be eliminated by not going outside. (*b*) They can practice good management, and thereby reduce the risk. A business with a good internal control system reduces the chance of loss resulting from employee dishonesty. (*c*) Business can accept the risk and handle the problem through the practice of self-insurance-that is, attempt to provide for coverage of loss through internal profit retention, Reserves set up to cover possible losses on accounts receivable and reserves set up to cover contingencies are examples of self-insurance. (*d*) Businesses can transfer the risk of financial loss to others. This is accomplished by buying insurance.

Not all risks are insurable. An insurable risk is one that meets the following criteria, among others: (1) There must be a large number of homogeneous units. This criteria is called the law of large numbers. In order to bring into play "the law of large numbers," many similar units must be exposed to the same risk. (2) The potential loss must be large enough to cause hardship. (3) The chances of loss must be predictable. For example, the risk of dying is insurable because, while no one individual knows when he may die, the percentage of people of a certain age who will die in a given year can be predicted with accuracy. If these conditions are met, the insuring company may agree to provide coverage for a specified fee. That fee is called a *premium.* The size of the premium depends upon the insurer's estimate of the probability of a claim being activated.

Insurers in the United States are either privately owned or operated by a unit of the government-state or federal. Examples of government insurance are workmen's compensation and the coverage under the old-age, survivors, and the disability insurance system. Privately owned companies may be of two types: stock companies and mutual companies. Stock companies are owned by the stockholders, whereas mutual companies are owned cooperatively by the policyholders of the company. Each policy holder is considered the owner of his proportionate share of the company; the larger the percentage of the company's assets invested in his insurance coverage, the greater the voice of the policyholder in the management of the company. Mutual companies are usually larger than stock companies in the life insurance field, while the stock companies account for most of the business in the nonlife fields.

The two major forms of insurance are life and property. Other classes of coverages are linked with one or the other of these or sometimes, as in the case of accident and health insurance, with both. Insurance may be further classified into distinctive coverages designed to protect against particular perils, as follows:(*a*) life insurance and annuities, (*b*) casualty insurance, (*c*) fire insurance, (*d*) ocean and inland marine insurance, and (*e*) crime, fidelity, and surety coverages. In addition, multiply-line insurance is written today by fire, marine, and casualty companies to provide one policy coverages. All-risk policies are also available on property.

Life Insurance and Annuities

Life insurance is designed to protect the insured's beneficiary from financial loss resulting from premature death, just as annuities protect the person from the financial disadvantages of living too long. Premiums are paid for life insurance protection, the amount being dependent on the age, and sometimes the physical health of the insured. By reference to statistically valid mortality tables, insurance companies can establish the death rate for people of various ages and charge a premium corresponding to the degree of estimated risk.

Annuities are actually a form of life insurance. They insure the individual from outliving his ability to provide an income. An annuity may be purchased outright for a lump sum or premiums may be paid annually as with life insurance. Benefits may begin immediately or may be deferred to a specific age. The older the person is when the annuity is purchased and the earlier in life benefit payments are to begin, the higher the annual cost.

There are three basic types of individual life insurance policies: (1) term insurance, (2) whole life insurance, and (3) endowment life insurance.

Term Insurance. Term insurance is exactly what its name implies--insurance in force over a specified term or number of years. At the conclusion of this term, the insurance merely expires, leaving nothing. Term insurance carries with it no cash benefits, and under certain conditions may not be convertible. Term insurance provides protection, nothing else. As a result, it is usually cheaper per year than any other form of insurance. Frequently, term insurance is taken out by businessmen on their credit customers to serve as a protection in case the customer should die before paying his bill.

Whole Life Insurance. Whole life insurance, also known as straight life or ordinary life insurance, covers the policyholder for his entire life, not just for a specified term. This is the most popular of all forms of personal life insurance policies. Premiums are based on the mortality table. Premiums may be paid in three ways (1) by the single-premium plan (payment of a lump sum at the time the policy is issued), (2) the continuous-premium plan (the insured pays a flat sum annually as long as the policy remains in force), and (3) by the limited-payment life plan. Under the latter plan, payment of premiums takes place over some fixed number of years, after which no further payments need be make. Thus, the policyholder can arrange to pay all his premiums during the period when his income is highest. Many people arrange to have their policies paid at age 65."

Ordinary or whole life is convertible into other forms of insurance and also possesses a cash surrender value. This is the accumulated excess of the premium over the annual cost of providing the year's protection. In other words, the annual premium is usually greater than the actual cost of providing a year's protection early in the life of the insured. This is because of the level-premium feature that balances out the low cost of the insurance early in life with the high cost later. The excess premium would normally be invested by the insurance company, but it is available for the policyholder to borrow.

Endowment Life Insurance. An endowment policy is one in which the insurer promises to pay a specified amount of money to the beneficiary of the insured if he dies during the endowment period, or to the policyholder himself if he is still living at the end of that period . In other words, the endowment policy combines the features of a savings plan with insurance protection. Naturally, since the policy must be paid in full at maturity, premiums are high, making such policies less popular.

As mentioned, there are three types of individual life insurance policies. However, life insurance can also be obtained on a group basis.

Group Insurance and Pensions. With group insurance, a group is covered as a whole under a master contract. Usually, group insurance is of the "term" type. Health examinations are not required, and many who would be unable to secure insurance individually can do so as members of a group. The cost of protection is shared and is therefore lower. To be eligible, a group must meet certain requirements and share some common purpose other than that of securing insurance. Group health insurance is widely held as well as group life insurance.

Group pension plans, too, are widely employed. These plans may be funded (an actuarially sound fund is developed for payment of benefits), or unfunded (the employer pays benefits out of current income). If funded, the plan may be insured or not insured. Certain tax advantages may be secured under plans that qualify.

Casualty Insurance

A second form of insurance is casualty insurance which covers a wide range of financial losses, but the most common are: (*a*) automobile collision insurance, (*b*) automobile liability insurance, (*c*) theft, (*d*) public liability insurance, (*e*) workmen's compensation, and (*f*) accident and health insurance, collision insurance, and theft. A business also needs to have these policies, although a much more important one to them is public liability insurance. This insurance protects the business firm from liability in the event of injury caused to customers (the public) while they are on property owned by the business or are receiving services provided by the business.

Workmen's Compensation. Every state in the union has passed laws creating systems for workmen's compensation. These have redefined employer's liability and have provided for insurance coverage to protect employees against losses due to injury while in the employ of a company.

Accident and Health Insurance. Accident and health insurance is written both by casualty and by life insurance companies. Such "hospitalization" policies are among the most widely held forms of insurance. They frequently consist of group contracts designed to protect the employees of a particular company. Typically, these policies cover loss of life through an accident as well as losses due to various degrees of disability. Sickness or health insurance protects against a wide variety of illnesses, including mental illness.

Fire Insurance

The standard fire insurance policy provides specialized protection against losses caused by fire or lightning. Since a large portion of all property loss claims are related to fire losses, this insurance is treated separately. Usually, fire insurance does not cover damage caused *indirectly* by fire. That is, losses resulting from a business' inability to continue operating immediately after a fire, usually is not covered by fire insurance. Such protection can be obtained, however, through the inclusion of a "consequential losses" clause in the contract. Also, fire insurance sometimes will only pay a portion of the losses caused by a fire. This is because of a "coinsurance" clause that is customarily found in most policies. Under this clause, the business is usually required to have fire insurance protection equal to some percentage (such as 80 percent) of the value of the asset insured. Unless at least this much coverage is carried, the insurance company will only pay part of the losses.

Ocean and Inland Marine Insurance

Marine insurance is of two types: (*a*) ocean marine, and (*b*) inland marine. Ocean marine insurance protects against losses resulting on the high seas. Inland marine insurance covers losses caused via all modes of transportation--so long as it is internal to the nation.

Crime, Fidelity, and Surety Coverages

Crime coverages protect business firms and individuals from loss by burglary, robbery, and theft. Special crime insurance is written for banks. Fidelity bonding affairs protect against losses resulting from employee dishonesty. A bond is a contract under which one party binds himself financially to guarantee that another party will perform an obligation. Usually employees are bonded when their work necessitates handling large sums of cash.

Surety bonds provide protection against nonperformance of a contract. Common types of such bonds are court bonds, contract bonds, bonds of public officials, and license and permit bonds.

Recent Developments. In recent years, several states have authorized the creation of “no-fault” insurance. Under 'no-fault' policies, each party to an accident is reimbursed by his or her own insurance company, thus alleviating the need for lengthy and costly lawsuits in the settlement of claims. Only time will tell if 'no-fault' insurance can effectively lower the total cost of insurance to the consumer, however.

Chapter 16 Review Questions

1. One of the three basic types of individual life insurance policies is:

A. Casualty insurance

B. Term insurance

C. Workman's compensation

D. Fire insurance

2. An insurance policy that each party to an accident is reimbursed by his/her own insurance company is called:

A. No-fault

B. Ocean marine

C. Inland marine

D. Accident and health

Chapter 17:

Marketing

Learning Objectives:

After studying this section you will be able to:

- Identify functions and costs of marketing.

Marketing involves all of the activities necessary for goods and services to go from producer or supplier to the ultimate consumer. It can be differentiated from production in that production usually provides only "form" utility, whereas marketing provides the utilities of "place, time, and possession." Our society is consumer oriented, and therefore marketing tends to focus on the customer.

The beginnings of marketing can probably be traced back as far as civilization itself. Marketing was involved when the earliest man first traded some possession to another for some other good. Today, marketing is much more complex, but the concept is still the same. Get the goods and services from those who possess them to those who desire them.

The goods and services that are involved in the marketing concept involve both the consumer goods and industrial goods. Consumer goods are goods that are purchased by the ultimate consumer for personal consumption. They are in a form to be used without further processing. Industrial goods are goods purchased by intermediaries for direct use in the production of consumer goods. To the extent that these industrial goods are consumed by the intermediary, they resemble consumer goods; the distinction, however, is that these goods would not be purchased if their consumption were not directly or indirectly necessary in the production of other goods and/or services. Office supplies are an example of industrial goods that are consumed indirectly in the course of production operations.

For consumer goods and industrial goods to be marketed effectively, the goods themselves must have some basic appeal to those who would consume them. In the case of consumer goods, buying motives may be classified as (1) emotional and (2) rational or economic motives.

Emotional motives are characterized primarily by lack of logical reasoning on the part of the consumer. These are basically subjective in nature and are often made impulsively. Among the reasons for such buying behavior are the impulse to "keep up with the Joneses," a desire for status, and a desire for additional comfort or pleasure. Unfortunately, emotion plays a dominant role in encouraging many unnecessary purchases at the consumer level. In reality, however, buying motives may be mixed, and most of the total consumer purchases are a result of some blending of the emotional motives with the more rational ones.

Marketers have made lists of emotional buying motives based on various aspects of human needs. One such list might include: (1) satisfaction of the senses, (2) preservation of the species, (3) fear, (4) rest and recreation, (5) pride, (6) sociability, (7) striving, and (8) curiosity or mystery.

Rational or economic motives are those stemming from the buyer's logical reasoning and desire to make the best use of the available funds. For the most part, such motives are exhibited when a consumer buys products because: (a) knowledge on the part of the consumer convinced him the product in question was of outstanding quality, or (b) some logical consequence would probably occur as a result of the purchase that would enhance the long term goals of the consumer. An example of the latter reason could be the regular purchase of a certain brand of motor oil; the consumer knows that by using this oil for regular oil changes in his car, he can avert possible serious damage to his car-a very definite long-term goal. In rational or economic buying, the purchaser takes into consideration such factors as efficiency of operation, durability, reliability, and convenience.

Industrial goods are more often purchased on a rational basis--companies are less concerned with emotional aspects and more with the cost-profit picture.

Consumer goods can be classified into three distinct groupings: (*a*) convenience goods, (*b*) shopping goods, and (*c*) specialty goods. *Convenience* goods include all of the day-to-day regularly consumed items that are purchased with a minimum of thought and effort. Examples are toothpaste, gasoline, and detergents. *Shopping* goods are basically durable goods-those to which considerable attention is given. These include household furniture, appliances, and automobiles. *Specialty* goods are goods that are purchased only on occasion, are usually expensive, and for the most part, can be classified as luxuries. Examples would be fur coats, expensive jewelry, pianos, and organs. While the exact classification of goods according to these breakdowns will vary from individual to individual, it is still true that most goods fall in one of these three categories.

Functions of Marketing

Marketing can best be described by examining its specific functions. These are: (1) buying, (2) selling and sales management, (3) transporting, (4) storage, (5) standardization, (6) financing, (7) risk bearing, (8) pricing, and (9) obtaining market information.

The *buying* function concerns the acquisition of the materials that are used in the production of the product or products that are to be sold to the ultimate consumer. While the buying function occurs at all levels of business activity, the most important aspect concerns the buying of raw materials for use in manufacturing. This was discussed more thoroughly in the chapter on purchasing.

The *selling* function includes advertising and sales promotion, personal salesmanship, and other forms of personal and non-personal selling techniques. These activities are discussed in detail in Chapter 19.

The *transportation* function involves the handling and moving of goods from the point of production to the point of ultimate sale. Many times, these activities need to be duplicated; for example, goods may first be moved to a warehouse, then to a retail store, and finally to the consumer. Many forms of business find that their very success or failure hinges on the manner in which they perform this function. Examples of such industries would be the gas and oil industry and the perishable foods industry.

Storage facilities are needed so that goods may be produced all year, even if they are sold only during certain months. Those facilities also assist in the efficient distribution of goods. Storage and transportation are related and together account for much of the activities of such marketing institutions as warehousing, trucking, wholesaling, and even retailing.

Standardization of goods involves packaging of goods in such a manner as to facilitate both the transportation of these goods and their resale to the ultimate consumer; for example, cake mixes are sold in packages that are easy to transport and yet are of a size that will allow the housewife to merely add one or two eggs to the mix in order to make one cake. Imagine the inconvenience if she had to add 11/2 eggs, for example. Similarly, standardization has made possible the sale of goods by telephone or by mail, since the consumer knows the approximate size, shape, and amount of content in goods he is buying.

Financing facilitates the payment of money for goods and services and provides needed credit, and therefore plays a vital, though often overlooked, role in marketing. When goods are shipped to retail establishments and are accompanied by invoices asking payment by some future date, either the shipper or producer is providing temporary financing for the retailer. The retailer has use of the merchandise without having had to pay for it.

Risk bearing is a function that is automatically assumed by all businesses engaged in the marketing process. The danger or risk of obsolescence is a risk assumed by the producer, the warehouseman, and the retailer. The risk of loss by fire, flooding, or other acts of nature are inherently assumed by all who come into contact with the product as it is in the process of being sold. While some of this risk may be transferred, some of it must be assumed by parties within the marketing channel.

Pricing, of course, is one of the key functions of marketing. Determining the price at which to sell its products is critical to the final success of any business venture. If the price is too high, the product may not sell. If the price is too low, profit may suffer. Moreover, as the consumer becomes better educated as to alternative products, prices become even more critical as a factor determining a product's eventual success in the marketplace.

The *obtaining of market information*, in effect, completes the marketing cycle. Business continually strives to learn more about the consumer- his want, his motivations, and so on. This information enables the firm to modify and refine all of its marketing activities. Knowledge of consumer motivation, for example, can influence the advertising approach for a product (the selling function).

The Channel of Distribution

The sequence of market institutions by which goods are transferred from producer to consumer is known as the channel of distribution. This channel may go from the (*a*) producer directly to the consumer, (*b*) producer to a retailer to the consumer, or (*c*) producer to one or more wholesalers to a retailer to the consumer. As a rule, products of mass consumption usually travel the longer channels of distribution, whereas specialty items may be sold through one of the shorter channels of distribution.

Most of the functions of marketing are performed by various individuals along the channel of distribution. While it may appear that the longer route is less efficient than the shorter route, it is also a fact that the longer route often results in lower prices to the ultimate consumer than the shorter route. This is because of the larger population that can be exposed to the product being sold. Production economies can be realized if large amounts of a product can be sold, thereby lowering the per unit cost- and price-of each product.

Conclusion

Marketing is one of the most important elements in the business system. The cost of marketing goods today accounts for more than 50 percent of the final cost of the products being sold. Yet, without this vital activity, many of the goods, both consumer and industrial, that we know of and enjoy today would not be available, at any price, in the marketplace.

Chapter 17 Review Questions

1. Buying motives that are classified as rational and economic include:

A. Satisfaction of the senses

B. Rest and recreation

C. Outstanding quality of product

D. Fear

2. In marketing, the function that concerns the acquisition of materials that are used in the production of a product to be sold to the ultimate consumer is the:

A. Transportation function

B. Risk function

C. Buying function

D. Standardization function

Chapter 18:

Marketing Channels

Learning Objectives:

After studying this section you will be able to:

- Identify the role of the middlemen in the marketing channel.

When goods are marketed, they may travel various "routes" involving the use of different kinds of middlemen. This chapter discusses various types of middlemen and the services they provide.

Marketing Middlemen

Wholesalers are middlemen who purchase goods from producers with the intent of reselling the goods to another middleman; that is, the wholesaler does not purchase goods with the intent of selling them to an ultimate consumer.

Retailers purchase goods from producers and wholesalers with the intent of reselling them to the ultimate consumer. As a rule, retailers do not sell goods to other middlemen for resale to the ultimate consumer. Retailers are the final middlemen in the channel of distribution.

Wholesalers

There are several distinct types of wholesalers in existence, although the function of wholesaling in general does not vary significantly. These distinct types of wholesalers can be divided into two groups: (a) the merchant wholesalers and (b) merchandise agents and brokers.

Merchant Wholesaler. Merchant wholesalers are wholesalers who actually purchase from the producer the goods they intend to sell. In other words, they take title to the goods they resell. There are two major types of merchant wholesalers. There are (a) service wholesalers, and (b) limited-function wholesalers. Service wholesalers include exporters and importers, rack merchandisers, wholesale merchant distributors and terminal elevators. Limited-function wholesalers include cash-and-carry wholesalers, truck distributors, and others. The wholesalers differ primarily in the market they serve, the products they handle, or the functions they perform. For example, among the aforementioned service wholesalers were import and export wholesalers and terminal elevators. Import and export wholesaler deal primarily in the area of foreign trade. Terminal elevators-or grain elevators-deal primarily in the marketing of raw grain to bakeries and flour mills. Similarly, among the limited-function wholesalers mentioned were truck distributors and cash-and-carry wholesalers. Truck distributors sell goods to retailers directly from their truck or vehicle. Cash-and-carry wholesalers set up facilities where small merchants may pick up products for cash.

MERCHANDISE AGENTS AND BROKERS. Merchandise agents and brokers differ from merchant wholesalers in that they do not take title to the goods they sell, but rather act as an agent or broker for a producer in the resale of goods to retailers. Among the more popular merchandising agents and brokers are: (a) manufacturer's agents, (b) merchandise brokers, (c) commission agents, and (d) auction companies. Just as with merchant wholesalers, these agents and brokers differ primarily in the products they sell and the markets they serve. The broker's principal function is to bring buyers and sellers together. He really sells information.

Manufacturer's agents are typically representatives of several producers, selling these producers' goods within a select territory on a commission basis. Merchandise brokers, on the other hand, may represent either the buyer or the seller in a transaction, and also operate on a commission basis. Commission merchants are similar to the above two groups with the exception that they take possession of the goods they sell. Auction companies sell goods to prospective buyers on an auction basis, title passing upon completion of the sale. Usually, auction wholesalers have the power to accept any price or terms offered by prospective buyers. They are found in the commodities field, particularly in the selling of tobacco.

WHOLESALER FUNCTIONS AND SERVICES. When wholesaler's services are utilized in the channel of distribution, certain marketing functions usually are assumed by them for the manufacturer. Fundamentally, wholesaling functions parallel the basic marketing functions: (a) buying; (b) selling by contacting retailers that might wish to carry the manufacturer's product; (c) grading, storing, and transporting goods for the manufacturer, since the wholesaler will usually buy in large quantities and resell in smaller quantities to the retailer; (d) financing and risk-taking, since the wholesaler will, in all likelihood, pay for the goods he purchases, thereby releasing the cash investment of the manufacturer; and (e) gathering market information. The wholesaler may actually lower the total cost of distributing goods since he is a specialist in performing his functions.

Retailers

Retailers are middlemen who specialize in selling merchandise to the ultimate consumer. In many ways, this is the most critical stage in the entire marketing cycle, since it is at this point that goods face either acceptance or rejection by the consumer they were intended to please. Retailing institutions have undergone many significant changes over time, just as the consumer population has changed its buying habits and living habits.

The earliest type of retail outlet in this country (excluding the country peddler) were the trading post and the general store. While virtually nonexistent today, these outlets were, up to the time of the Civil war, the chief means of getting goods from producer to consumer. Today, their place has been taken by other types of retail outlets such as: (a) the department store, (b) the specialty shop, (c) the supermarket, (d) the discount house, and (e) the limited price variety store.

Department stores are characterized by the wide variety of goods they handle and their organization into separate departments for particular groups of products. Each store may carry hundreds of different lines of products, hoping to attract customers by offering them a large selection of goods in a general product line.

Specialty shops are very popular today, particularly with the growing desires of people to express their individuality in the products they purchase. Such stores can cater to this desire, since they specialize in one, or perhaps two particular products, and carry virtually a complete stock of merchandise within these product lines.

Supermarkets are essentially large grocery stores to which nonfood items have been added to the point where they resemble department stores. Supermarkets appeal to consumers by offering large selections at low prices, profit being made by successfully " turning over" rapidly the merchandise they sell. For the most part, supermarkets operate on the self-service principle, with the customer going to a check-out counter to pay for the goods. The supermarket technique has also spread to drug, hardware, and general merchandise, and other stores.

The discount house is, in effect, a department store that features price cutting and high turnover. Services to the customer in a discount house are at a minimum, products usually being sold on a serve-yourself basis.

Limited-price variety stores are stores that sell a wide variety of goods, the only common feature of the merchandise being the price range in which the goods are sold. Such stores were long typified by the "Five-and Dime" stores. For the most part, such stores have undergone a change in policy such that they hardly qualify as "limited price" store today.

Other forms of retailing that are growing in popularity are vending machines and the service retailer. It is likely that the retailing business will continue to change to accommodate changing consumer demands.

Wholesaler services for retailers. Where the retailer and the wholesaler are both found in a given channel of distribution, certain of the marketing functions that would normally be required of the retailer are performed for him by the wholesaler. These include; (a) simplifying buying problems for the retailer. Instead of visiting many producers to select goods to buy, the retailer may need visit only one wholesaler to see all available merchandise. (b) Prompt delivery. Because the wholesaler is buying in bulk from the manufacturer, he can provide prompt delivery to retailers needing goods. This reduces the storage problem for the retailer, (c) Credit facilities. By far, one of the most common sources of short term financing is trade credit. This actually is a form of financing provided by the wholesaler to the retailer who buys goods. (d) Merchandising aids. When a wholesaler sells goods to a retailer, he is eager to see that the retailer can successfully dispose of the goods. This generates a return business. Thus, the wholesaler is quite willing to assist the retailer in effectively displaying and advertising his merchandise.

Chapter 18 Review Questions

1. Merchants who purchase goods and take title of the goods from producers and wholesalers with the intent to resell them to the ultimate consumer are:

A. Merchant agents

B. Retailers

C. Brokers

D. Manufacturer's agents

2. Stores that sell complete lines of one or two products only are known as:

A. Supermarkets

B. Department stores

C. Discount houses

D. Specialty shops

Chapter 19:

Advertising and Sales Promotion

Learning Objectives:

After studying this section you will be able to:

- Identify advertising strategies and trends.

As the variety of goods and services available increases, it becomes more and more challenging for a company to acquaint potential customers with its products. The task of informing, educating, and preselling goods to the consumer is the function of advertising. Advertising can be defined as those non-personal techniques intended to inform consumers of available goods and induce them to purchase those goods. Sales promotion consists of various other managerial methods designed to coordinate and enhance the advertising effort.

Advertising of all types share the same basic functions, but these types can be conveniently divided on the basis of *who* advertises *what* to *whom* and *where* to bring about what *response.* Advertising can thus be classified as (a) commodity advertising or (b) institutional advertising. Commodity advertising is intended to acquaint the consuming public with a particular good or a particular brand of good. Institutional advertising is intended to acquaint the public with a particular company, to develop an image of the company, or to inform the public of some particular achievement of a company. To this extent, institutional advertising can be viewed as non-product advertising.

Commodity Advertising

Most advertising is of the commodity type. The advertising campaign should not, however, be dismissed as being mere publicity for products on a mass-media basis. The manner in which advertisements are presented is highly complex. For example, the advertising program may be intended to reach only a particular group of consumers, it may be intended for a particular geographic area, or it may be aimed at developing interest in a particular class of goods. The goal of the company regarding the good that is for sale is instrumental in determining the type of advertising program undertaken.

Advertising Media

The American Marketing Association's Committee on Definitions has prepared an illustrative list of advertising media. Included on it are: (1) magazines and newspapers, (2) radio and television, (3) direct mail, (4) outdoor advertising, (5) transit advertising, and (6) online advertising. There are, of course, many other advertising media. Each of the various media has certain characteristics that make it especially well adapted to a certain market segment.

Magazines usually have a national readership; that is, the audience they teach ranges from coast to coast. The distinguishing feature of magazines is the nature of the audience to which it appeals. Magazines on sports, for example, offer a selected readership suited for advertising products appealing to sportsmen. Companies producing any type of goods for a particular market of consumers will seek out magazines appealing to that market.

Newspapers usually serve a concentrated market on a day-to-day basis. Regardless of the size of the market, many people read a daily newspaper. Accordingly, for stores and businesses selling within that market, newspapers offer an attractive, low-cost means of reaching that market. Newspapers are particularly useful at informing the public of day-to-day changes of goods.

Most radio programming is local, but some network programs have a national audience. And while it may be common to think of radio as a dying medium, there are usually several radios in the typical American home and in almost every automobile. Teen-agers, housewives, and sports fans all can be reached through radio advertising as they listen at various times of the day to their programs.

Television is today's most important advertising medium. The tremendous advantage of television is the ability to reach a nationwide audience on a daily basis with both picture and sound. The major drawback to television is the cost, but its effectiveness has been proven many times.

Direct mail is defined as "a vehicle for transmitting an advertiser's message in permanent written, printed, or processed form, direct to selected individuals." It need not necessarily be mailed. The more personal appeal of direct-mail advertising is one of its primary distinctions and is a reason for its continued popularity. It delivers its message on a selected, individual, rather than a mass, basis.

Outdoor advertising is typified by the billboard seen along the roadside. The products advertised are those that normally would appeal to the traveling public. Outdoor advertising also consists of semi-permanent or even permanent signs at strategic locations in cities.

Keyword searches are the most common form of online advertising, and are the largest source of Google’s revenue. Banner ads are also a popular form of online advertising. Banner ads are graphic images in Web pages that are often animated and can include small pieces of software code to allow further interaction. Online ads most importantly are “clickable,” and take a viewer to another Web location when chosen. More and more companies doing business online find that the best way to reach prospective customers is through their Web searches. After all, most customers looking to make a purchase online start with a keyword search. Online advertising also includes social media marketing, which can include campaigns conducted through social media sites where consumers are spending an increasingly large amount of time. Online provides a more measurable form of advertising: costs are known, clicks and impressions are known, and retailers can track conversions when online advertising is done properly.

Transit advertising is typified by the ads appearing in or on public transportation vehicles and taxicabs. Car cards are the most common form of such advertising. While the audience reached by each ad may not be large, it is well defined and is captive, even if only for a brief period.

Examples of other forms of advertising media are novelties, skywriting, store signs, posters, dealer displays, packages and labels, films, and so on.

Advantages and Disadvantages of Advertising

The critical role that advertising plays in the marketing concept has been both praised and attacked by various people in society. Proponents of advertising claim that advertising (a) is responsible for the successful adoption of mass-production techniques in our country; (b) stimulates production and employment by inducing people to buy the merchandise being offered for sale; (c) is responsible for stimulating a competitive attitude in our economy, and thereby is indirectly responsible for the introduction of new products and better products for the consumer; and (d) educates the consumer as to the availability of new products and of new uses for old products. Taken together, these arguments make a strong case for the virtues of advertising.

At the same time, however, an equally strong case can be made against advertising. Critics claim that advertising (a) frequently causes the consumer to purchase goods that, in reality, he neither needs nor can afford; (b) creates demand for goods that have little economic value, the intent being to give companies something to produce for sale; (c) is often useless in that frequently sales of goods would be just as high without all of the advertising; (d) frequently costs so much that products cost more than they would if they were not advertised; (e) frequently is in poor taste, and is an insult to the intelligence of the consumer; and (f) is often misleading and prone to exaggeration as to the quality of goods.

The argument as to the worth of advertising has been going on for years, and undoubtedly will go on for many years to come. Still, several facts are undeniable. Advertising has made the American consumer the most knowledgeable consumer in the world, pays most of the cost of our newspapers and all the costs of television and radio programs, and has contributed in some degree to the general preservation of a competitive business society.

Sales Promotion

The basic aims of sales promotion are to inform, persuade, and remind potential and actual customers about the company and its products. It coordinates and increases the effectiveness of the advertising and personal selling efforts.

Four of the most common types of sales promotions involve: (a) samples, (b) premiums, (c) point-of-purchase displays, and (d) contests.

Samples of goods are small portions of a product given free to selected consumers as a means of introducing the product to the consumer. Since people are more inclined to buy goods with which they are familiar, the theory behind sampling is that the consumer will become familiar with the product and seek it out on the shelf of the retailer. The use of samples becomes even more effective when it is coordinated with an advertising campaign extolling the virtues of the product. The sampling technique, a highly effective way of introducing the public to new products, is most commonly used for household items, such as soap and detergents, and personal items, such as razor blades and toothpaste.

Premiums may be in the form of a coupon found inside a package; to get the premium, one must first purchase the product. Other premiums are distributed in the mail as a form of inducement to try a particular product. Still others, usually those found on the package itself, involve the mailing in of a coupon to receive some special offer.

Point-of-purchase displays are intended to appeal to impulse buyers, that is, those individuals who purchase products on impulse, not because of any previously felt need or desire for a particular product. Such store display may incorporate special price reductions or some seasonal attraction as inducements to purchase.

Contests usually offer the customer a chance to win a prize by participating in some kind of game. In some instances, purchases of the commodity are not required. Contests have been very popular as promotional devices in the sale of magazines.

Giving trading stamps with purchases is a sales promotion technique used by many types of business-especially supermarkets. The stamps may be exchanged for merchandise of all sorts, and although the stamps add to the price, they seem to many customers to offer something for nothing, or at least a chance to get some item that they think they could not otherwise afford. Extra stamps may be offered as inducements to purchase particular items.

Packaging, too, is used for promotional purposes. The package may have protective or convenience features (moisture-proof envelopes, easy dispensers); it may carry what amounts to an advertising message or directions for use; and it may be so designed as to be attractive in itself or useful for a secondary purpose.

Combined, advertising and sales promotion have one ultimate purpose: to convince the consumer that he should purchase the product being offered for sale. They have greatly facilitated the transfer of goods from the producer to the consumer.

Chapter 19 Review Questions

1. Advertising defined as “a vehicle for transmitting an advertiser’s message in permanent written, printed or processed form direct to select individuals” is known as:

A. Transit advertising

B. Outdoor advertising

C. Direct mail

D. Radio programming

2. One of the disadvantages of advertising is:

A. The responsibility for successful mass production techniques

B. Creates a demand for goods that have little economic value

C. Stimulates production and employment

D. Educates the consumer

Chapter 20:

Salesmanship and Marketing Management

Learning Objectives:

After studying this section you will be able to:

- Identify attributes of a sales program.

Salesmanship is the art of *personal* persuasion used to convince others to purchase or desire to purchase goods. Traditionally, sales management has been viewed as the management of such sales-related activities as recruiting and selecting a sales force and then training, evaluating, compensating, supervising, and motivating these salespeople. However, the responsibilities of the sales manager have been greatly expanded in many instances to include such related activities as product planning, pricing, sales forecasting, customer service, channel considerations, and advertising. As more and more firms become "marketing oriented" and with the increasing growth of consumerism, the sales manager of today is becoming more involved in the whole spectrum of marketing activities. Today the broader conception usually goes by the name of *marketing management*. This is the management application of the marketing concept-that is, focusing on satisfaction of the customer's need. Marketing managers develop strategic marketing plans involving target markets and a "marketing mix." They blend personal selling, advertising, and sales promotion into an integrated marketing program.

Salesmanship

Personal selling still remains, as it has been in the past, one of the key influences in the continuing development of the American economy. Without creative personal selling, it is unlikely that our present variety and abundance of products would have been possible.

Some of the same arguments that were advanced for and against advertising in Chapter 19 could also apply to personal selling. But it is undeniable that the assistance and information given by the salesperson in the purchase selection of goods. More and more, too, the high-pressure, ruthless type of salesmanship is giving way to the service-oriented, professional, and customer-oriented type which is better suited to today's marketing concept.

Types of Sales Persons

The U.S. Department of Commerce classifies sales persons as (1) manufacturer's sales persons, (2) wholesaler's sales persons, (3) retail sales persons, and (4) specialty sales persons, including sales engineers.

Manufacturer's sales persons are often classified as (a) dealer-servicing sales persons, or (b) distribution sales persons. The dealer-servicing salesman's job is primarily to maintain a regular supply of products to dealers already carrying the manufacturer's product and keep them satisfied. He may, however, be expected to find new dealers from time to time. Distribution sales persons, on the other hand, have as their primary function the finding of new middlemen to handle the manufacturer's products.

Wholesaler's sales persons are employed to facilitate the services offered by wholesalers to retailers. Their function is to assist the retailer in the merchandising of his goods. The theory underlying the function of the wholesale salesman is that, by assisting the retailer in marketing his goods, the wholesaler will generate increased sales to the retailer.

Retail sales persons deal directly with the consuming public. They are typified by the sales clerks behind the counter found in most retail stores. It is to their credit that the American business system maintains the vitality it exhibits today, for their function involves the final steps in getting the products to the ultimate consumer.

Specialty sales persons, or door-to-door sales persons, are somewhat of a vanishing breed in America, as the shopping center, mail-order catalogs, and mass advertising become more predominant. Also included among specialty sales persons is the sales engineer, who sells highly technical and complex products and frequently must have a college degree in engineering or science to qualify for his job.

The Selling Technique

The art of selling is a highly refined and carefully executed operation. It involves a number of distinctive steps. These are discussed in the following paragraphs.

PROSPECTING. The ability to distinguish potential customers from noncustomers is critical if the salesman is to effectively utilize his time and efforts. To some extent, the salesman's job is simplified because of the concept of market segmentation, that is, the designing of a product to appeal to a certain segment of the total market. Knowing this market can simplify the salesman's job of identifying his customers.

PLANNING, DELIVERING, AND DRAMATIZING THE SALES PRESENTATION. Before actually calling on the prospect, the salesman must spend some time planning his promotional pitch. Only after doing so does he proceed to deliver his sales presentation, which consists of everything he does and says during the sales interview. He may dramatize this presentation through the use of demonstrations, films or slides, and charts and pictographs.

The sales presentation is designed, first, to *arouse customer interest.* Interest is most readily aroused by appealing to the buying motives of the customer. As discussed earlier, buying motives may be either rational or economic or they may be emotional. The salesman can arouse interest in a customer by understanding these motives and by determining which of the motives is most likely to influence a particular prospect.

In his presentation, too, the salesman must develop the prospect's *desire* for the product. This can be done by answering the questions posed by the consumer, and by convincing him of the benefits he will gain from the product.

HANDLING OBJECTIONS. In all sales interviews, there comes a time when the prospect voices some objections. These may be based on natural sales resistance, a desire to get rid of the salesman, lack of sufficient money, or failure to recognize the benefits the product might have for him. The salesman must be able to overcome all these barriers for a successful conclusion to his selling effort.

CLOSING THE SALE. The final step in the selling process is often said to be that of closing the sale. Once the customer has been convinced that the product offers something of value to the consumer, and that he really wants the product, it would seem that nothing is left but to close the sale. For some sales persons, this *is* the end of the cycle, but for others, hoping for return business, this may be only a step toward a continuing relationship. They may call on the customer time and time again, each time inquiring about the performance of the last product the consumer purchased. This is an excellent way to interest consumers in new products carried by the salesman.

Sales Compensation

Basically, there are three types of compensation plans used for sales persons: (a) straight salary, (b) commission, and (c) salary and commission. Salesmen operating on a straight salary are given a stated dollar salary regardless of the number or dollar amount of sales they record during the pay period. Although this has its advantages for the new salesman, it does limit the incentive for the experienced salesman, since he may no longer have the personal incentive to increase sales. Each customer can become just another nuisance that interrupts his solitude.

Salespeople operating under a straight commission have the advantage of the built-in incentive. Their problem, however, is one of ethics. Some "high-pressure" sales persons will resort to any means to get the customer to buy and thereby register a commission. The ultimate effect on the manufacturer of the product maybe to damage its goodwill and reputation.

The generally accepted best form of compensation is a form that blends qualities of both of these types. This is the salary-plus-commission method of compensation. Under this system, the salesman is guaranteed a given salary, with the stipulation that sales in excess of a given amount will generate commission revenue for the salesman. Thus, the salesman is somewhat reluctant to misrepresent the product and company to gain a sale, since he may be jeopardizing his salary. Yet, if he is energetic and successful, the limited commission concept can reward him handsomely. Compensation plans that involve bonuses operate much the same as those plans utilizing both salary and commission.

Sales and Marketing Management

There are basically three levels of authority in the sales management hierarchy: (a) administrative, (b) operating, and (c) staff. The administrative sales management personnel concern themselves with the planning function, the organizing and developing of new markets, and the hiring of new salesman. The operating echelon concerns itself with the execution of the policies of the administration. The staff echelon concerns itself with the specialized problems that occasionally arise in the area of sales.

The marketing manager's job is much broader and more complex than that of the sales manager as traditionally conceived. He is responsible for the master marketing plan, that is, for selecting the target markets and developing the most effective marketing mix for reaching these targets. He must direct the implementation of this plan through decision making in the selection of products and of channels of distribution, advertising, selling, promotion, and pricing. Then, like any other manager, he must initiate and maintain a system of control.

Chapter 20 Review Questions

1. The selling technique that has the ability to distinguish a potential customer from a non- customer is:

A. Prospecting

B. Planning

C. Handling objections

D. Closing the sale

2. Generally the best form of compensation for a sales person is:

A. Straight salary

B. Commission

C. Salary and commission

D. Fixed percentage of sales

Chapter 21:

International Business

Learning Objectives:

After studying this section you will be able to:

- Identify the concerns and consequences of, and the governmental role, in international business and trade.

International business involves the exchange of goods across international borders. Sometimes this exchange occurs because of the existence of branches of a business in foreign countries. Many companies are multinational corporations (MNCs) that have significant foreign operations deriving a high percentage of their sales overseas. These companies seek to expand their markets, increase efficiency of production and marketing operations, and take advantage of favorable differences in costs. These MNCs, too, can have advantages to the host country in the supplying of needed capital and the production of lower-cost and more easily available consumer goods.

Although there are a number of obstacles to trade across borders, it will tend to take place wherever the prices of commodities differ more than the cost of shipment-provided that these obstacles do not impose insurmountable burdens. The amount and kind of commodities that will be traded vary from country to country. The degree of self-sufficiency of the country is an important determining factor. Similarly a country will tend to export goods that are comparatively inexpensive at home and import goods that are comparatively inexpensive abroad.

Determining which goods are "comparatively inexpensive" at home, or are "comparatively inexpensive" abroad, is a decision that is usually influenced by the *Law of Comparative Advantage.* This law simply states that a country tends to produce those goods in which its comparative advantage of production is greatest. This advantage is usually a function of climate, know-how, geography, amount and skill of the available labor force, etc. For example, Brazil exports coffee to the United States and imports machinery from the United States because of the comparative advantages of each country in relation to the products involved. Under the concept of comparative advantage, total world output will be maximized when each nation specializes in the products in which it has the lowest opportunity cost, that is, a comparative advantage. When nations specialize in what they produce most efficiently and then exchange with others, more is produced and consumed than if each nation tries to be self-sufficient. Specialization of labor is beneficial for individuals; the same principle applies to nations

Sometimes a country's advantages with respect to a commodity are so overwhelmingly great (or even exclusive) that it can be said to have an *absolute advantage*. An absolute advantage exists when one country can produce goods that the other cannot duplicate. Yet, in the complicated trade relationships among countries, absolute advantages have very little importance. It is the *comparative advantages* which determine what products a country will export and what it will buy from another country.

One of the major concerns of countries all over the world is their *balance of trade* and their *balance of payments*. The balance of trade is considered favorable if exports (sales of goods to other countries) exceeds imports (the purchase of goods from other countries.) When a country realizes a favorable balance of trade, this means that-on balance-it is receiving more foreign currency (which can be used to buy foreign goods) than it is paying out in its own currency.

The balance of trade, although important, is but one aspect of the balance of payments. The balance of payments is considered favorable if the total inflow of funds exceeds the total outflow of funds. Naturally, the balance of trade (exports vs. imports) constitutes a large part of the balance of payments. But it is not the only factor. Foreign aid, military expenditures, tourism, etc., all enter into the determination of the balance of payments.

Obstacles to International Business and Trade

The establishment of branches in foreign countries is made more difficult by restrictions and regulations imposed by foreign countries. Laws may restrict foreign ownership, impose operational burdens, or even, in some parts of the world, lead to expropriation. Also, the businessman operating in a foreign country must adapt to the cultural differences between that country and his own.

Chief among the obstacles to international trade are: (a) distance, (b) transportation costs, (c) language barriers, (d) cultural differences, (e) differences in monetary systems, and (f) government-imposed barriers, notably the tariff.

Distance. Obviously, distance from the home base complicates all phases of international trade, adding to transportation costs, making marketing more difficult, and reducing the ease of communication.

Transportation Costs. Shipping costs are a major obstacle to international trade and trade will not take place unless the price or other advantages exceed these costs.

Language Barriers. Certainly, anyone who has been overseas knows the difficulties of communication created when different languages are spoken. Not only the language itself but differences in idiomatic expression which sometimes can only be appreciated by a native to the country complicate business communication and can produce costly and embarrassing mistakes in marketing operations.

Cultural Differences. Culture can play an important role in international business and trade. This is particularly true in advertising and sales promotion. Ignorance of cultural taboos and manners and customs of a foreign country can create serious problems.

Differences in Monetary Systems. With different countries having different monetary systems, international trade can only take place if the monetary unit of one country can be readily exchanged for that of another. This necessitates the establishment of a system of exchange and rates of exchange-creating complex problems. The problems are further complicated by inflation within a country, monetary policies of the country, or currency devaluations.

Government-Imposed Barriers. Often times governments put barriers in international trade. Sometimes these barriers take the form of import quotas-restrictions on the physical shipment of certain goods into or out of the country. More commonly, governments use tariffs to influence foreign trade. Tariffs are excise taxes on imported goods imposed either to generate revenue or protect domestic producers. Domestic industries tend to press for tariffs on the goods they make. In recent years, tariffs have been assailed because they tend to deny the consumer the comparative advantages of importing foods and they injure the prospects of international trade. It would seem that if different countries have different resources and know-how that give them different comparative advantages, trade between them would be of mutual benefit and should not be hindered.

In Defense of Tariffs

There are several arguments that are usually posed in defense of tariffs. These are as follows:

The Military Argument. This states that it is in the national interest of a country to develop certain industries itself, even if these goods can be produced elsewhere. In time of war, such skills and goods may be necessary for the continued welfare of the nation.

The Infant Industry Argument. This holds that the country has an obligation to protect its infant industries from the more powerful competition from abroad. Although this argument has some validity, governments are usually reluctant to remove the protective tariffs even after the industry has outgrown infancy.

The Favorable Balance-of-Trade Argument. This argument claims that it is necessary to maintain tariffs so that the country can control its balance of trade. By restricting imports, a favorable balance will result. The fallacy here is that other countries are likely to retaliate by imposing similar tariffs.

Financing International Trade

When goods are sold in foreign markets, payment in currency of the seller's country is accomplished through the mechanism of international payments. The demands for payment by the sellers in one country are balanced with those of another through clearing institutions, mainly the banks in the leading financial centers. There exists an interconnected international network of banks that have checking accounts with one another and can shift funds back and forth. The overall balancing of the accounts between nations is accomplished through movements of capital from one country's bank balances to another's, borrowing from the International Monetary Fund, and even (in the past), actual shipments of gold. If one country mismanages its financial resources, it may have to devalue its currency, as Britain and the United States have done in recent years.

One popular instrument used to facilitate foreign transactions is the *bill of exchange* . A bill of exchange is a draft issued by the seller of the goods requesting the buyer to accept the terms indicated on the draft. The buyer "accepts" the draft by writing "accepted" across the face of the note, thereby creating a "trade acceptance." This document instructs the buyer to pay the stated amount to a third party, usually a bank, which then credits the seller's account for the amount of the sale. Bills of exchange may be dated in such a way as to make the obligation due immediately (in such cases it is known as a sight draft), or the bill may be given a specific due date (when it is then considered to be a time draft).

When bills of exchange are utilized in international trade, it is customary to also use several other documents. Chief among these is the bill of lading. The bill of lading is a certificate indicating title to the goods in transit. This is usually sent by the seller to his bank. The bank releases the bill of lading when it is given the trade acceptance by the buyer. Also required as a matter of course are various insurance policies covering the goods, export and import licenses, and other documents that may be required by the various governments.

Another popular method of international financing is through the use of a commercial letter of credit. This letter, written by a prospective buyer's bank, states that the bank stands ready to honor the commitments and obligations of the buyer. Such a letter of credit is highly regarded in international business, for it indicates the general creditworthiness of the prospective buyer far better than could be done by any other means.

Chapter 21 Review Questions

1. When one country can produce goods that another country cannot duplicate it is known as:

   A. A cultural difference

   B. Absolute advantage

   C. Imposed barrier

   D. Language barrier

2. A certificate indicating title to goods in transit is:

   A. Bill of exchange

   B. Commercial letter of credit

   C. Insurance policy

   D. Bill of lading

Chapter 22:

Ethics and Business Law

Learning Objectives:

After studying this section you will be able to:

- Identify key provisions regarding with business law and ethics.

American business has ethical standards derived from the Puritan ethic that was prominent in England in the 1600s. Brought to America by the Puritans from 17th century England, this ethic greatly influenced the development of the American capitalistic system of free enterprise. As a result, the business system, like the teachings of the puritans, advocates thrift, hard work, and honesty. This embodiment of a value system in the structure of our business system is a critical factor, for this value system today takes the form of an ethical code of conduct that permeates not only business but also all of our modern society.

Our American system would not last long if it were unable to keep the trust and confidence of the consuming public. The "trust" in our business system is fundamental to the success of our economic enterprises. So too, is the knowledge that behind all personal and business transactions lies a code of laws that can be invoked if necessary. Accordingly, our legal system, together with a strong ethical notion of right and wrong, combine to reinforce the trust in the American economic system.

Business Law

Our legal system derives from 18th century English common law, and for the most part, centers around (a) contracts, (b) agencies, and (c) the law regarding financial and negotiable instruments.

Contracts. A contract is an agreement between two or more parties in which one party agrees to perform some stipulated service and receive from the other party a fee or award for this service. Contracts are at the heart of the American business system-the whole realm of business depends on contracts between two or more parties.

For a contract to be legal and to be enforceable, however, certain conditions must be met regarding (a) the nature of the contract, (b) the parties to the contract, and (c) the terms of the contract.

In order for a contract to be enforceable, an offer must have been made and accepted, and consideration or remuneration for the services performed must have been agreed on. Also, two other conditions must be met before the contract is legally enforceable. First, the agreeing parties must both be competent people-in the eyes of the law. For example, under some instances, minors are not considered "legally competent: for the purpose of making contracts. Second, the contract itself must be lawful- a contract that involves a breach of the law is unenforceable.

Although contracts may be either written or oral, it is customary for them to be written. The existence of a valid, oral contract can be difficult to prove unless there were witnesses to the contract formation.

Agencies. The agency is a fundamental part of the business system. Basically, an agent is one who is authorized by another party, called the principal, to act on behalf of the principal in transactions involving third parties. Agents have, therefore, a great deal of power and influence, although their powers must be carefully defined and controlled to prevent wrongdoing of the agent from causing misfortune to the principal. An agent is considered to be absolved of blame; (that is, the principal is responsible) for acts committed by an agent that are within the scope of the assignment of the agent. Such acts may be within either (1) the stated or explicit scope of the agent, or may be (2) within the implied or apparent scope of the agent. For example, if an agent had been violating conditions of his agency for some time, such that third parties became accustomed to dealing with him, the principal would be responsible for acts of that agent during a given transaction, simply because the agent appeared to have authority to act in this manner on behalf of the principal. Such authority is called apparent authority.

Negotiable Instruments. A negotiable instrument is a document that is transferable from one party to another by endorsement and delivery in lieu of a cash payment. It is important to emphasize that these documents, or notes, are transferable-this is the key feature of negotiability.

Most states follow the advice and rulings of the Uniform Commercial Code with regard to negotiable instruments. The Commercial Code states that such instruments must (a) be in writing and be signed by the maker of the note; (b) contain an unconditional promise or order to pay a "sum certain" in money; (c) be payable on demand or at a definite time; (d) be made payable either to a specific party, or to bearer; and where this note or document is made payable to a specific party, this party must be clearly identified on the face of the document.

There are basically three major types of negotiable instruments: (a) checks, (b) promissory notes, and (c) bills of exchange.

A check is a draft signed by the maker ordering a bank to pay a certain sum to a third party, called the payee, on the order of the payee. A promissory note is a signed promise, written by the maker to another party, promising to pay him a specified amount at a stated time. A bill of exchange is a promise to pay a specified sum at a specific time. It is issued by the seller of goods, sent to the buyer of the goods, who then accepts the bill, thereby confirming the promise. It is most often used in international trade.

For a negotiable instrument to be properly executed, it must be endorsed. The endorsement may take any of several forms, but the following forms are among the more common.

A *blank endorsement* merely involves the payee signing his name across the back of the instrument. At that time, the negotiable instrument becomes payable, in effect, to the bearer of the instrument. There are no qualifications to the payment of the amount of the instrument.

A *special endorsement* involves making the instrument payable to a third party, by endorsing it over to him. Thus, the payee would write " pay to the order of...," and sign his name, thereby making the instrument payable only to the person so named in the endorsement.

A *restrictive endorsement* specifies the disposition of the funds or the amount of the instrument. For example, an endorsement stating "for deposit only" would restrict the use that could be made of the proceeds of the instrument.

A *qualified endorsement* is more concerned with the liability feature in the event the instrument should or should not be honored. For example, the phrase "without recourse" indicates that the endorsee absolves himself of all liability for the eventual payment of the check. When an endorser writes this before his name on the endorsement of the instrument, the endorsement is considered to be a "qualified endorsement."

Other Legal Considerations. The areas of contracts, agencies, and negotiable instruments, while not the only aspects of business law, are certainly among the most important. Other areas of importance involve: (1) partnerships, (2) corporations, (3) sales contracts, (4) bankruptcy, (5) garnishment of wages, (6) liens, and (7) personal property.

Business Ethics

Throughout modern civilization, man has lived according to two sets of guidelines. One of these was the law, usually written, although also based on historical precedents. Individuals were assured of certain rights under the law, and if these rights were violated, recourse was available to them.

The second set of guidelines that has shaped man's destiny is the set of unwritten judgments that civilized man makes in determining his particular mode of conduct. These judgments are influenced by what is considered to be right or wrong; that is, what activity is considered proper, honest, and fair, and what activity is not. This second set of guidelines is referred to as *ethics*, or as applied to business decisions, *business ethics.*

Accounting Scandals Bring about New Guidelines and Legislation

The past several years have witnessed a number of high-profile corporate scandals: Enron, Tyco International, K-Mart, and Worldcom (now MCI). The Sarbanes-Oxley (SOX) Act lays down stringent procedures regarding the accuracy and reliability of corporate disclosures, places restrictions on auditors providing non-audit services and obliges top executives to verify their accounts personally. Section 409 is especially tough and requires that companies must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis. Under the Act, CEOs and chief financial officers must personally vouch for the truth and fairness of their company's disclosures. And those financial disclosures will be broader and better than ever before. Corporate officials will play by the same rules as their employees. In the periods when workers are prevented from buying and selling company stock in their pensions or 401 (k)s, corporate officials will also be banned from any buying or selling.

Corporate misdeeds will be found and punished. The SEC will now have the administrative authority to bar dishonest directors and officers from ever again serving in positions of corporate responsibility. The penalties for obstructing justice and shredding documents are greatly increased.

Note: 90% of business schools now provide some form of training in business ethics. Today, ethics in the workplace can be managed through use of codes of ethics, codes of conduct, roles of ethicists and ethics committees, policies and procedures, procedures to resolve ethical dilemmas, ethics training, etc.

Chapter 22 Review Questions

1. In order for a contract to be legal it cannot be:

A. Accepted

B. Have consideration or remuneration

C. Accepted by a minor

D. Competent in the eyes of the law

2. Legal aspects of business law applied to contracts, agencies and negotiable instruments will NOT include:

A. Sales contracts

B. Business ethics

C. Garnishments of wages

D. Liens

Chapter 23:

Government and Business

Learning Objectives:

After studying this section you will be able to:

- Recognize government influences on business.

The growth of the American business community has been aided in many ways by the federal, state, and local governments. Government has provided the legal foundation for business, coined the money without which it could not operate, educated its labor force, and rendered direct assistance in many ways. It has always regulated business to some extent, usually not without opposition from businessmen. Yet, regulation has not been so restrictive as to slow business development.

The founding fathers of this country sought to maintain a free, independent economic system, fearing the concentration of both economic and political power in the hands of a few. Accordingly, when they wrote the Constitution, they gave the federal government very few specific powers, reserving most of them for the states. Today, most of the powers and regulatory influence of the federal government stem from broad interpretations of several clauses and amendments to the Constitution. For example, Article I, Section 8 of the Constitution gives Congress the Specific right to coin money, levy taxes, provide for the defense and the welfare of the nation, and regulate trade among the states. The 16th Amendment to the Constitution gave Congress the specific right to levy an income tax. From these two basic items in the constitution comes the broad base of precedent for the limited, although effective, level of government intervention and regulation in effect today.

For the first 100 years of this country's existence, regulation of commercial activity consisted largely of court decisions under common law. For the most part, the American economy was a "laissez-faire" economy, meaning that it was largely free from intervention by the government. In the late 1800's, and early 1900's, legislation was passed by states, because of certain abuses suffered by people that were brought about by the misuse of power by certain influential businessmen. These laws, among others, outlawed agreements to restrain trade, required safe and sanitary working conditions, insured workers against industrial accidents, established minimum hours and wages for women, and forbade misrepresentation of securities.

Federal Legislation

The first major piece of federal legislation affecting the business community was the Interstate Commerce Commission Act of 1887. This act was intended to regulate the activities of the railroads, primarily, and did this by establishing an Interstate Commerce Commission which had the power to set rate schedules, grant rights-of-way, and in other ways direct the activities of the transportation industry. The power of the Interstate Commerce Commission has grown with time, however, and today its influence is felt in all areas of business, particularly interstate business.

Congress responded to the misuses of power by big business by passing the Sherman Antitrust Act in 1890. This act outlawed monopolization by industry and conspiracies where the intent was to monopolize. It stands today as the landmark antitrust law, and serves as the basis for most of the other subsequent antitrust legislation passed since then.

In order to exercise some degree of control over the banking industry, Congress, in 1913, created the Federal Reserve System. The Fed, as it is known, is a semiautonomous agency charged with the regulation of monetary policy within the United States. It is responsible for maintaining bank liquidity, providing ample credit within the economy, and assisting the federal government in the sale of its bonds and other debt instruments.

By 1914, it was apparent that the Sherman Antitrust Act was too broad an act to carry effective enforcement in court. Accordingly, Congress passed the Clayton Act in an attempt to redefine parts of the Sherman Act. Passed as an amendment to the Sherman Act, the Clayton Act outlawed those activities that tended toward monopolization. It also outlawed specific acts, notably exclusive sales contracts, interlocking directorates, tying contracts, and discrimination among buyers of the same goods.

Also in 1914, Congress passed the Federal Trade Commission Act. Whereas the Sherman Act and the Clayton Act were intended to prevent monopolization and practices that tended toward monopolization, the Federal Trade Commission Act attempted to regulate all "unfair" business practices. To determine what was fair and what was unfair, the act established a Federal Trade Commission, whose job it was to oversee competitive practices within the economy.

Although designed to regulate competitive practices, the Federal Trade Commission Act did not carry much legal power. The Commission could issue "cease-and-desist" orders but could not levy large fines and/or prison sentences on violators. Accordingly, new laws were needed to assist in the proper enforcement and regulation of unfair competitive practices.

In 1936, the first of the acts to strengthen the Federal Trade Commission was passed. This was the Robinson-Patman Act, and its main concern was with unfair marketing practices. The most important provision of this act was to make illegal all discrimination between buyers of commodities where the purchased product was of similar quality and quantity. The act was intended to regulate the activities of the large retailers, particularly the chain stores, who had been able to demand special favors from suppliers, thereby putting the smaller retailers at a distinct competitive disadvantage.

This act was followed in 1938 by the Wheeler-Lea Act. The Wheeler-Lea Act extended the authority of the Federal Trade Commission to those practices that resulted in injury to the consumer, even if no apparent change was made in the competitive status of the industry. It also gave the Federal Trade Commission the power to levy fines for violations of these statutes.

Finally, in 1950, Congress again attempted to preserve competition in the economy by passing the Celler-Kefauver Anti-merger Act. This act prohibited all mergers and corporate acquisitions where the result was to lessen competition. With the passage of this act, the number of horizontal mergers (mergers between competing economic units) and the number of vertical mergers (mergers between companies within a channel of distribution) drastically declined.

Other government legislation occurred in this time period in the areas of labor and finance. These, however, have been discussed earlier in the course.

Other Governmental Influences

The power to tax is given to the government in the Constitution. Thus, government influence is particularly evident in the area of taxation. The federal government has many different types of taxes, each tax designed to place the burden of payment on (a) those most able to pay the tax; (b) those most affected by certain areas of governmental assistance; and (c) the widest possible number of people, thereby reducing the impact of those taxed.

The best-known federal and state taxes are: (1) the personal income tax, (2) the corporate income tax, (3) the sales tax, (4) the property tax, (5) excise taxes, (6) custom duties, and (7) specialty taxes.

The personal income tax is the largest single source of revenue for the federal government. The federal income tax is a graduated tax, with those earning the most income generally falling in the highest taxpaying brackets.

The corporate income tax is a tax levied against the income of all profit-making corporations. The tax rate is quite high, the result being that the corporate income tax is the second largest source of revenue for the government. This tax is levied only against corporations, with the income earned by partners and sole proprietors being treated as individual personal income.

The sales tax is a widely used tax at the state and local level. This tax is often levied on the purchases of all consumer goods. Some states, however, exempt food and drug purchases from this tax on the belief that they are necessities of life and therefore should not be taxed.

Property taxes are another common source of revenue for state and local governments. These taxes are usually based on the assessed valuation of the property, and proceeds from these taxes frequently are used to pay the cost of such things as public education.

Excise taxes are specialized taxes that are levied, for the most part, against luxury items. Jewelry, guns, cameras, perfumes, and automobile tires are typical items that may carry an excise tax charge.

Custom duties are levies that, ostensibly, are designed to restrict the flow of imports into the country. These taxes are levied against imported goods, particularly goods that compete with American-made items. The tax is intended to reduce or remove the attractiveness of the foreign-made good and increase the marketability of the American-made good.

Specialty taxes can be likened to excise taxes. Perhaps the most familiar of the specialty taxes is the gasoline tax, a federal or state levy placed against every gallon of gasoline sold. State governments have also utilized specialty taxes a great deal, notably on gasoline, cigarettes, and liquor.

Government Services

Regulation and taxation are two of the more powerful governmental influences on our economic life. All government, however, is not necessarily negative or restrictive in its effect. For example, government is responsible for providing postal service, certainly a service that modern business could never do without. Government also constructs roads and airports, and builds and patrols harbors, parks, and other places of amusement and relaxation.

More importantly, government has taken steps in the area of welfare that have greatly assisted the business community in meeting the needs of the people. Social security and Medicare have served the needs of millions of people, and have, at the same time, created millions of new consumers for goods that business is eager to provide.

The maintenance of a system of weights and measures, and the proper management of a judicial system have also been instrumental in creating an atmosphere where the American economic system can flourish and thrive. Our "limited, private enterprise" system is today the strongest economic system ever devised by man, and we possess the highest standard of living ever seen. The partnership of government, business, labor, and the support of the citizenry are the key factors underlying this success.

Chapter 23 Review Questions

1. The first piece of federal legislation to regulate the activities of railroads, set rate schedules and grant right-of-way is:

A. The Sherman Antitrust Act

B. The Interstate Commerce Commission Act

C. The Federal Reserve System

D. The Robinson-Patman Act

2. Taxes that are levied to restrict the flow of imports from foreign countries into the USA because they compete with American-made items are:

A. Excise taxes

B. Sales taxes

C. Custom duties

D. Corporate income taxes

Glossary

Absolute Advantage: The economic advantage one country enjoys when it can produce products other countries cannot duplicate.

Acid Test Ratio: The ratio of cash and near-cash items to the total current liabilities. Often, this is referred to as the quick ratio.

Accounting: The recording, classifying, summarizing, and interpreting of financial data.

Advertising: Non-personal selling techniques designed to inform customers and induce them to purchase the product or service being advertised.

Agency, Law of: That specialized part of the law dealing with the rights, authority, and obligations of persons who have been employed to act on behalf of another, called the principal, in transactions involving third parties.

Alien Corporation: A corporation whose charter was obtained in a foreign country.

American Federation of Labor: The major labor union for craft workers; this union was founded by Samuel Gompers and is generally considered the successor union to the old Knights of Labor.

Analytic Process: Those production processes that separate a commodity into its basic, component parts.

Application program---Computer software written specifically to process data in an information system. It performs tasks and solves problems applicable to a manager's work.

Arbitration: The process by which a disinterested third party is engaged by the disputing parties in labor negotiations and given the power to dictate the terms of settlement.

Array: A listing of all values in a statistical sample, frequently from highest to lowest.

Articles of Co-partnership: Also known as the Partnership Agreement, this document itemizes all important aspects of a partnership agreement, including salaries, place of business, terms of dissolution, and so on.

Ascribed Status: The attaining of a position of status within a firm on the basis of factors other ***than*** accomplishment.

Ask Price: The price at which an individual may purchase a given share of stock on the stock exchange or over-the-counter.

Assets: Those properties (both tangible and intangible) of value owned by a business firm or by an individual.

Authority: The power to make decisions, command, and delegate responsibility to others, 14

Balance Sheet: A financial statement that reveals the assets, liabilities, and owner's equity in a firm as of a specific date.

Balance of Trade: The difference between a country's imports and its exports. If imports exceed exports, the result is an unfavorable balance of trade; if exports exceed imports, the result is a favorable balance of trade.

Bear Market: A phrase or slogan attached to the stock market when the general direction of price changes is down.

***Bid price*---**The price at which securities may be sold on the stock exchange or over-the-counter.

Big Board: A slogan or slang term meaning the New York Stock Exchange.

***Bill of Lading**: A* negotiable receipt issued by a transportation company signifying title to goods in transit.

Binary Code: The arithmetic language that utilizes only two digits, zero and one, which is commonly used in electronic computers.

Blacklist: Lists of names of individuals sympathetic to the labor movement which were circulated among businessmen. Workers whose names appeared on the lists found it difficult to find employment. The blacklist is now illegal.

Blue-Sky Laws: The name given to the series of state laws which were passed in order to regulate security issues and their promoters within the boundaries of a given state.

Board of Directors: The elected representatives of stockholders, charged with managing the overall policy of the firm on behalf of the stockholders.

Break-Even Point: That level of output (and sales) that exactly equates the costs of production with the revenues received from sales of the product. Also looked at as that level of output required to produce a zero level of profit.

Broker: A registered representative that assists customers in buying and selling securities in the stock and bond markets.

Budget: A financial plan indicating expected revenues and anticipated expenses for a specified period, such as a year, which can be used as a means of exercising financial control.

Bull Market: The name attached to conditions surrounding a rising level of prices on the stock market.

Business: The economic activity of providing goods and/or services to others for a profit.

Call Option: A clause in a bond indenture agreement giving the issuing company the right to call in, or retire, bonds in advance of their stated maturity date.

Capital: Money, goods, land, or equipment used to produce other goods or services. *Capital goods* refers to the tools or other productive agents by which resources are transformed into usable products.

Capital Budget: A budget devoted solely to the acquisition of, and depletion of, major capital equipment within a business firm.

Capitalism: An economic system that allows for private ownership of all of the factors of production and allows individuals choosing within the confines of the system to determine what, how, when, and why products are to be produced or services rendered; the enterprise system.

Caveat Emptor: A phrase that was attached to the practices of early businessmen, meaning let the buyer beware."

Central Tendency, Measure of: A statistical measure that refers to the average score of a frequency distribution.

Channel of Distribution: The route by which goods travel from producer, usually through middlemen, to ultimate consumer.

Chattel Mortgage: A mortgage that carries a lien on the movable property of a business firm.

Closed Corporation: A corporation whose stock is not available for purchase by the general public.

Closed-End Investment Companies: Investment companies whose available stock is limited in amount, thereby letting the demand and supply for these shares determine their market value. Usually, stock of closed-end companies sells somewhat below the asset value.

Closed Shop: A labor-management agreement whereby the company is prohibited from hiring anyone who was not a member of the labor union. This shop was outlawed by the Taft-Hartley Act of 1947.

Coinsurance: A clause commonly found in fire insurance policies which limits the liability of insurance companies unless the insured has a minimum percent of the value of the property insured.

Collective Bargaining: The process in which labor representatives and management representatives sit down together to discuss a mutual settlement of their differences.

Commercial Paper: Unsecured debt obligations of large corporations, usually with short-term maturities.

Commission: The charge assessed by a broker for his services to customers buying or selling securities.

Common Stock: The certificates indicating ownership rights for a corporation. Each share of common stock carries the right of ownership of some fraction of the company.

Communism: The economic system under which private property is eliminated and all productive assets are operated and controlled by the state.

Comparative Advantage: The economic advantage one country can enjoy over others in the production of a given commodity, if it specializes and concentrates on production of that product. This is the reverse aspect of *comparative cheapness,* which determines what products will be traded.

Congress of Industrial Organizations: The first major labor union designed for the trades people, it grew rapidly in strength from its inception in the 1930's until its merger with the AFL in 1955.

Consideration: The legal term for the compensation granted by one party in a contract in return for some service or product. This is essential to the creating of a binding contract.

Contract: A legally enforceable agreement between two or more competent parties, requiring one party to perform some service in exchange for some form of consideration; the written evidence of such an agreement.

Contract Buying: An agreement between a supplier and a purchasing agent providing for deliveries of commodities by the supplier to the purchasing agent's company over a specified period of time at a specified price.

Control Unit: The portion of a computer system that interprets the instructions, or programs, that were stored in the computer's memory unit.

Controlling: That function of management concerned with coordinating and regulating activities to assure performance in accordance with standards and plans.

Convenience Goods: Goods utilized in our day-today living. These refer particularly, to nondurable goods.

Convertible Bonds: Bonds that can be exchanged for common stock in the same company, at the option of the bondholder.

Convertible Preferred Stock: Preferred stock that can be exchanged for common stock in the same company at the option of the stockholder.

Coordinating: The judicious assignment of tasks and responsibilities so as to effect a smooth, orderly operation within the business firm.

Corporate Charter: The legal document required of all corporations which states the purposes, nature of, and principal owners and organizers of the company.

Corporation: A legal entity created by governmental charter (state or federal) for the purpose of carrying on activities stated in the charter. An artificial being created by law, possessing those characteristics assigned it in its charter. May be organized for profit or not for profit.

Correlation Analysis: A statistical tool that measures the degree of dependency between two or more variables and the average amount of change in one variable associated with a unit increase in another. In *simple* correlation, a dependent variable is related to just one independent variable. In *multiple* correlation, the dependent variable is related to two or more independent variables.

Coupon Bonds: Bonds whose interest is payable to the bearer of small coupons attached to the bond certificate. Each coupon is negotiable on the date specified on the coupon.

Cumulative Preferred Stock: Preferred stock whose unpaid dividends in arrears must be paid in full before any dividends can be paid to common stockholders in future periods.

Current Assets: Those properties of a company that are expected to be consumed or converted to cash within a fiscal year.

Current Ratio---A measure of liquidity, the current ratio is the ratio of current assets divided by current liabilities.

Custom Duties: Levies or taxes assessed against selected imported goods.

Cyclical Trends: Fluctuations in the level of activity of an economic index that generally last for several years before changing direction.

***Data Processing**:* A system of gathering, storing, and processing of data.

Dealer-Servicing Salesmen: Manufacturer's salesmen whose primary task is to service and otherwise assist current customers.

Debentures: Unsecured corporate obligations promising to pay a specified sum at some future date. An unsecured bond issue.

Debt-Equity Ratio: The debt-equity ratio shows the percent of the business that is financed by creditors in relation to that financed by owners. It is computed by dividing total liabilities by total owners' equity.

Decision support system (DSS)---Branch of a management information system that provides answers to management problems and that integrates the decision maker into the system as a component. DSS software provides support to the manager in the decision making process. It analyzes a specific situation and can be modified as the manager desires. Examples of applications include planning and forecasting.

Delegation: The arbitrary assignment of the power of decision making to another.

Depreciation: The financial charge representing the portion of the cost of a fixed asset that has been consumed in a given accounting period.

Discount House: A retail establishment that specializes in selling goods in high volume at low unit profits. Such stores usually handle a wide variety of goods and sell primarily on a self-service basis.

Discount Rate--The rate of interest that the Federal Reserve System charges its member banks for loans made to them.

Distribution Salesmen: Manufacturer's salesmen whose primary function is to find new middlemen to handle the manufacturer's products.

Domestic Corporation: A corporation operating within the state in which it was chartered.

Drafts: A financial instrument involving an order to pay a certain sum from one party to a third party.

Economic Order Quantity (EOQ): A quantitative technique for determining the optimal size of reorders of goods.

Endorsement-Blank: An endorsement of a financial instrument that makes the instrument payable to bearer on demand.

Endorsement-Qualified: An endorsement of a financial instrument that restricts the liability of the endorsee in the event the financial instrument is not honored.

Endorsement-Restrictive: An endorsement of a financial instrument that specifies the disposition of the funds indicated on the face of the instrument.

Endorsement-Special: An endorsement of a financial instrument that transfers the financial claim to a third party.

Endowment Life Insurance--A form of life insurance that combines insurance protection with a savings plan, maturing in a fixed number of years, and paying the face of the policy even though the insured is living.

Entrepreneur*: One* who undertakes risks and responsibilities and combines the basic factors of production in an effort to create an economic unit known as a business.

Equipment Trust Bonds: Bonds which carry title to major capital equipment as collateral.

Esteem: The regard a person is held in by his peers, subordinates, or superiors.

Excise Tax: Specialty taxes designed strictly for revenue-raising purposes and levied against luxury items.

Exports: Goods sold to other nations or to individuals or businesses in other countries.

Extractive Enterprises: Businesses engaged in the processing or removing of materials (for example, minerals) from their natural state.

Fabricating Process: The formation of consumer and industrial goods from the products produced by the other production processes.

Facilitating Enterprise: Enterprises engaged in activities not directly related to the production of goods but which are essential for the flow of goods to reach the consumer.

Factors: Individuals or businesses that perform a finance function by purchasing accounts receivable from other companies.

Factors of Production: Those essential elements necessary for the production of goods and services. These factors include natural resources, labor, capital, and entrepreneurship or management.

Featherbedding: A practice of keeping personnel on the payroll even though the job the individual performs has become obsolete and inefficient.

Federal Reserve System: The quasi-public central banking structure of the United States that is charged with overseeing the monetary policy of the United States and the operations of its national banking system.

Fidelity Insurance: Insurance designed to protect against financial loss resulting from the dishonesty of an employee.

Financial Institutions: Businesses that assist other businesses, consumers and government by channeling funds from those having excesses to those having deficits.

Fixed Assets: The land, plant and equipment, and. other physical productive assets of a firm that are expected to have a useful life in excess of one year.

Fixed Costs: Those costs a business firm expects to incur regardless of the level of actual output, and whose magnitude is not subject to fluctuation during the planning period.

Flow Chart*: A* diagram or schematic chart showing the logical sequence of instructions to be followed in a computer program; a diagram showing the relationships among the parts of an operation used to assure proper integration of the entire process.

Forecast: An estimate of future business activity.

Foreign Corporation: A corporation operating in a state other than the one in which it was chartered.

Fractional Reserve System: The concept that requires commercial banks to keep only a portion of their deposits on hand as reserves backing deposits. The rest of the deposit is loaned out, thereby creating deposits for other people. The effect is a magnifying of the loaning power of commercial banks and a resulting increase in the supply of money.

Franchise: An operating agreement in which one party (the franchisee) agrees to operate a business developed by another (the franchisor).

Frequency Distribution: An ordered array of numbers, with the frequency of occurrence of each score duly noted.

Functional Organization: An internal business organization that divides authority and responsibility on the basis of function, thereby making each function somewhat autonomous.

Futures Market: That portion of the commodities markets where contracts calling for future delivery of particular commodities, are bought and sold.

Gross Profit: That profit earned on sales after deducting the cost of the goods sold but before deducting other business expenses.

Hardware-The term applied to the system of equipment that comprises a data processing unit.

Horizontal Mergers: Mergers between companies whose operations compete, or that perform roughly the same function in the economy.

Imports: Merchandise purchased from foreign countries or from foreign businesses.

Income Bonds: Bonds on which interest is earned only if the issuing company earns a profit sufficient to pay the interest.

Income Statement: A financial statement revealing the summary of the income or loss resulting from the business transactions for the preceding period.

Index Number: A statistical number that measures the amount of change (as compared with a "base" amount) over time for a specific item. For instance, if prices increased by 50 percent from year X to year Y (and X is the base year), then 150 is the index number representing the price level in year Y.

Injunction: A court order barring certain activity from taking place.

Inland Marine Insurance: Insurance that covers losses caused during the transporting of goods inside the territorial limits of a nation. Its coverages include goods in domestic transit; motor cargo insurance; bridges, tunnels, and other instrumentalities of transportation and communication; and various types of property floater policies.

Input Unit: The means by which data is entered into the computer's memory unit.

Institutional Advertising: Advertising intended to acquaint the public with a particular company, to develop an image, or to inform the public of some achievement of the company.

Insurance: Means by which a businessman can transfer the risk of financial loss to others for a premium.

Intangible Assets: Assets possessing no physical characteristics, but whose value lies in the legal rights or in the name and reputation of the company.

interlocking Directorate--A situation in which two or more companies dealing in the same type of prod- uct or product lines have the same boards of directors.

Intermittent Production Process: The production process followed by most companies in which production occurs only during a portion of the day or night, but not both.

Interstate Commerce Commission: The government agency charged with the regulation of all business activity that involves transportation between or among several states.

Inventory Turnover: The number of times the average inventory of a firm is replaced during a given period.

Joint Venture--A short-term undertaking by two or more corporate parties to achieve a particular goal.

Journal: The books of original entry used by accountants to record financial transactions.

Jurisdictional Strike: A strike waged by competing labor unions in an effort to persuade management to recognize one or the other as the legitimate bargaining group.

Knights of Labor: The first of the national labor movements, its success spurred the growth of the AFL and the modern organized labor movement.

Laissez-Faire*: A* French term meaning “let people make or do what they choose.” It connotes freedom from government intervention in the affairs of business.

Law of Large Numbers: A concept used in insurance which states that it is possible to predict occurrences, such as death, among a group of people possessing the same general health characteristics, if the group is large enough.

Leadership: Th***e*** ability to direct the activities of others toward the solving of a problem or the accomplishment of a goal.

Ledger: Individual account books that keep a running balance of the status of each account. From the ledgers, the balance sheet and income statement can be prepared.

Legal Entity: A legal person, artificially created by law, possessing most of the rights and privileges of a real person. This description applies to corporations.

Liabilities: Debts owed by individuals to others and the equity of creditors in business firms.

Line Organization: An internal business organization structure characterized by the strict, vertical flow of authority and the lack of assistants at the various executive levels.

Line and Staff Organizations: The internal business organization structure that much resembles the line organization, with the exception that it employs staff members, or assistants (who possess no actual line authority), to assist the regular line supervisors.

Lockout: A tactic used by management to prevent striking workers from entering the plant.

Management: The process of combining and guiding the factors of production to achieve the desired goals of the business firm.

Management information system (MIS)--- A computer-based or manual system which transforms data into information useful in the support of decision making.

Manufacturers' Agents: Representatives of a producer or several producers who usually sell the producers' goods on a commission basis within a given territory.

Manufacturing: The process of adding value by changing the form of goods.

Marketing: The process by which goods and services are distributed. The overall selling effort of a company.

Mass Production: The volume production of products or goods that have identical characteristics.

Mean: The arithmetic average of a distribution of scores, obtained by summing all of the scores and dividing by the number of scores in the distribution.

Mechanization: The use of machines and machine power in the production of goods.

Median: The middle score in an ordered array of scores. An average.

Mediation: The labor-management bargaining process in which a disinterested third party is brought into the discussions to listen to both sides and offer suggestions for resolving the dispute.

Merchandising Agents: The class of wholesalers that do not take title to the goods they sell but act on behalf of the producer of the goods in making the sale.

Merchandising Mix: The proportions in which personal sales promotion and non-personal sales promotion techniques are utilized by a business firm in marketing its goods.

Merger*:* The uniting of two previously independent business units into one larger unit.

Middlemen: Those businessmen acting in some capacity within the channel of distribution between the producer of the goods and the consumer of the goods.

Mode--The average score in an ordered array as depicted by the score which occurs most often.

Monopoly: The sole ownership or control of the productive capabilities necessary for the providing of a given product or service.

Mortgage Bonds: Bonds or promises to pay secured by a lien on real property.

Mutual Companies: Companies whose ownership lies with the customers of the firm; the more business done with a customer, the greater is that customers' proportionate share of ownership in the firm.

Negotiable instrument: Financial instruments whose ownership can be transferred by endorsement and delivery to a third party.

Net Income: The earnings of a company after allowing for all legitimate business expenses, including taxes.

Ocean Marine Insurance: Insurance that protects against losses incurred to goods being shipped on the high seas.

Open-end Investment Companies: Investment companies whose shares are purchased directly from the company. Also known as mutual funds.

Open-Market Operations: The operations of the Federal Reserve System when it buys and sells government bonds from and to member banks.

Open Shop: A shop in which employment is open to all, regardless of whether or not the individual belongs or desires to belong to a union.

Operating Expenses: Those expenses incurred because of the productive operations of the business firm.

Ordinary Life insurance--Another name for straight life, this is the most common form of permanent life insurance. It is characterized by a constant premium which is paid for life, the policy coming due only on the death of the insured.

Over-the-Counter Market*:* The somewhat informal market for the purchase and sale of bonds and common and preferred stocks not listed on an organized exchange.

Par Value--The stated or printed value of a share of stock; the price at which securities are issued.

Participating Preferred Stock: Preferred stock that enjoys the right to participate or share with the common stockholders in dividends paid by the firm over and above the fixed preferred dividend.

Partnership*: A* non-corporate business venture of two or more persons.

Permanent Life Insurance--Life insurance that remains in effect until the death of the insured, provided the premiums on the policy are paid.

Planning: The function of management that determines what shall be done, how it shall be done, why it shall be done, and by whom.

Point-of -Purchase Display*:* Store displays or merchandise displays located at or near the point of purchase.

Preferred Stock: A form of corporate ownership funds that have prior claims or assets over common stock, but whose claim is still subordinate to the claims of creditors. Preferred stock usually carries a fixed return, much like debt securities.

Prestige: The recognition accorded an individual because of his status within a firm.

Primary Boycott*:* The refusal of company workers to patronize the products of the company against whom they are striking.

Primary Data: Data obtained firsthand, from the originating source.

Private Corporation: The most common of all corporations, these are companies owned by one or only a few individuals.

Processing Enterprise: See Extractive Enterprises.

Production: The process of creating economic value, of transforming raw materials into goods or services that possess utility.

Profit*:* In ordinary accounting terms, profit is the excess of sales revenues after deducting all related expenses. *See also* Net Income.

Programmer: The individual who writes the instructions for processing by art electronic computer.

Promissory Note--An unsecured, short-term debt instrument in which the maker promises to pay the payee a specified sum at a certain time.

Proprietorship: A term referring to the owners' equity in a firm.

Purchasing: The procurement of the right goods necessary for production, at the right price, with the right quality, in the right quantity, for delivery at the right place and at the right time.

Reciprocity: A practice between two or more parties where one party agrees to purchase commodities from the other party if the other party will obligate himself to return the favor.

Registered Bonds: Bonds that have the name of the owner written on them and whose ownership is recorded in the company records in order to protect the bondholders against loss or theft.

Reserve Requirements: The legal requirement of the Federal Reserve which stipulates what percent of a bank's deposits must be kept available to handle claims for withdrawals.

Responsibility: The accountability for results that occurred because of the decisions that were made.

Retailers: Those middlemen who actually sell products to the final consumer.

Retained Earnings: Those earnings of a company that are not paid out as dividends to stockholders but are reinvested in the firm.

Return on Investment*: The* ratio that indicates the profitability of a business firm. It is computed by dividing total stockholder's equity into net income.

Right-to-Work Laws: Those state laws that, in effect, outlaw the union shop, thereby, allowing workers a chance at employment regardless of whether or not they have union affiliation.

Round Lots: Usually, lots of 100 shares of common stock. On occasion, some other number of shares may constitute a "round lot."

Sampling: The process of selecting a portion of an entire "universe" for study with the expectation that certain characteristics of the entire group will be discovered.

Seasonal Trends: Changes in an economic index that are caused by, or related to, changes in the seasons of the year.

Secondary Boycott: The refusal of workers to deal in any capacity with businesses that handle the products of the company against which the workers are striking.

Secondary Data: Data obtained from sources other than the originating source.

Secular Trend: The long-term movement or trend of change in an economic index.

Serial Plan: A plan for the retirement of corporate bonds, based on the registration number of each bond.

Shopping Goods: Also known as durable goods, these are items purchased by households that are essential for day-to-day living but which are considered important enough to warrant careful shopping (for example, refrigerators and automobiles).

Sinking Fund: An accounting technique of accumulating enough funds to retire a bond issue when it comes due.

Slowdown Strike: An informal type of strike in which workers remain on the job, but drastically cut their productivity.

Socialism: An economic system in which the key industries, or "core" industries, are owned and operated by the state.

Software: The computer program or set of instructions written In computer language that instructs the computer in performing the particular operations; the totality of programs and routines used to extend the computer's capabilities.

Sole Proprietorship: An unincorporated business firm with a single owner.

Specialty Goods: Goods that are purchased only on occasion, are usually expensive, and are generally classed as luxuries.

Speculative Buying: Purchasing of raw materials in advance of their use because of the belief that supply or price will change unfavorably in the future.

Spot Market: The market for buying and selling commodities for cash and immediate delivery.

Spreadsheet---Table of numbers arranged in rows and columns to make accounting, finance, marketing, and other business calculations. Spreadsheets facilitate end-result summary numbers, "what-if" experimentations, and projections.

Standard Deviation: A statistical measure that shows the extent to which the scores in an array are distributed about the mean.

Statistics: A branch of mathematics involving the collection, analysis, interpretation, and presentation of masses of numerical data.

Status: The relative position of a person has achieved in an organization.

Strike: A deliberate stoppage of work in an effort to force management to accede to certain union demands.

Surety Bond: A bond or insurance to protect against the nonperformance of others.

Surrender Value, Cash: The accumulated excess of the premiums on life insurance over the annual cost of providing a year's protection, which can be borrowed by the insured at his option.

Sympathy Strike: A strike waged by members of other unions as a show of support for a union that has called for a formal strike against a company.

Syndicate: joint venture that is organized for the purpose of carrying out a single transaction, usually selling a new issue of stock.

Synthetic Process: That production process concerned with the procedures that "build up" or assemble a product from its basic elements.

Tariffs: Taxes placed on imported goods.

Term Insurance: Nonpermanent insurance in which protection is provided only for the length of the specified term, after which all benefits cease to exist.

Trade Acceptance: A draft drawn by the seller asking the buyer to "accept" the terms of the draft. Upon acceptance, the trade acceptance becomes another draft.

Trade Credit: The credit which is given by a shipper of goods to the recipient of the goods before payment for the goods has to be made.

Tying Contract: A contract that requires the recipient of goods to accept other goods as well as part of a "packaged" arrangement.

Union Shop: A shop in which all employees are required to join the union either before accepting employment or shortly thereafter.

Utility: The useful and necessary characteristics of all products that are usable by consumers, namely, form, time, place, and possession.

Variable Costs: Those costs whose total magnitude varies directly with the level of production.

Vertical Merger*:* A merger of firms performing different but related functions ***as*** within a channel of distribution. For instance, the merger of a manufacturer, wholesaler, and retailer would be an example of a vertical merger.

***Walkout Strike**:* The most popular of all strikes, this is typified by the sudden departure of all workers from their jobs.

***Warehouse Receipt**:* A negotiable storage receipt for goods placed in a warehouse. It signifies title to the goods.

Whole Life Insurance: A type of life insurance contract written not for a specific term but for the entire life of the insured. It is classified according to how premiums are paid as single premium, limited payment, or continuous premium.

Wholesale Merchants: Wholesalers that take title to the goods they resell to retailers.

Wholesalers: Middlemen in the channel of distribution that buy goods from producers or other whole-salers and generally resell them to retailers.

Wildcat Strike: A strike called spontaneously by workers at a company, without the sanction of union headquarters.

World Wide Web (WWW): Internet system for world-wide hypertext linking of multimedia documents, making the relationship of information that is common between documents easily accessible and completely independent of physical location.

Working Capital: The excess of current assets over current liabilities; or those funds used to finance day-to-day operations.

Yellow-Dog Contract: A document once required by management for workers to sign, in which the worker swore he was not a member of a labor union and would not become one.

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Review Question Answers

Chapter 1 Review Questions

1. The manpower necessary to transform resources into products and services is:

   A. Incorrect. Land refers to all natural resources, water, minerals, forests, and land itself but does not refer to manpower.
   B. **Correct.** The manpower that is necessary to transform the resources in to products and services is labor.
   C. Incorrect. Capital may refer to machinery, equipment, buildings, and financial assets used to hire labor and buy equipment.
   D. Incorrect. Entrepreneurship refers to the human skill of using the resources of land, labor, and capital in an effective allocation to earn a profit/

2. Under American capitalism as opposed to pure capitalism the most significant difference is:

   A. Incorrect. For the most part pure capitalism is evident in the American enterprise system including the freedom to own property.
   B. Incorrect. Under the American economic system, the government does have a role, but it is restricted by the American Constitution which does allow for freedom of choice.
   C. **Correct.** The American enterprise system is generally thought of as a form of modified free enterprise. Under pure capitalism, individuals possess (a) the freedom to own property, (b) freedom of choice, (c) freedom to compete, (d) freedom to determine their own personal incentives and goals, (e) the opportunity to use the profit motive to their personal gain, and (f) complete freedom from government influence. The American economic system, for the most part, also grants these freedoms. There are, however, restrictions imposed on some of them, the most significant of which arise out of the unique relationship of government and business.
   D. Incorrect. In the American enterprise system the freedom to compete is a basic right.

Chapter 2 Review Questions

1. The greatest single drawback to a sole proprietorship is:

A. Incorrect. Managerial freedom requires the owner to possess many entrepreneurial skill to raise capital to develop the business, hire and train any needed personnel, market and advertise the product or service, obtain insurance ,and obtain business licenses where required.
B. Incorrect. A sole proprietorship is not a tax paying entity because taxes can be offset by expenditures and other legal "loopholes." The owner must be responsible for all taxes required to legally operate the business.
C. Incorrect. In a sole proprietorship the owner is responsible for both the profit and or loss. The owner risks his or her capital to develop, operate and maintain the business.
D. **Correct.** Unlimited liability is the greatest single drawback to sole proprietorship. It puts a heavy financial burden and responsibility on the owner and in times of disaster it can bankrupt the individual.

2. The disadvantage of a corporation may include:

A. Incorrect. Perpetual life of the business is incorrect because the perpetual life of a corporation is an advantage and not a disadvantage that makes ownership easily transferable.
B. **Correct.** Stockholders have to pay income taxes on dividends received. The stockholders as well as the corporation pay income tax on the earnings and dividends making it "double taxation" and a disadvantage.
C. C is incorrect because limited liability of the owners is an advantage and not a disadvantage.
D. D is incorrect because the right to sue or be sued is an advantage of the corporation. The corporation possesses almost all of the rights and obligations of a real person.

Chapter 3 Review Questions

1. The function concerned with the evaluation of all the activities of the firm and the comparison of those activities is the:

A. Incorrect. The organizing function involves the utilization of men, material, money and machines and does not involve evaluation and comparison.
B. Incorrect. The actuating function concerns the blending together of all the distinct departments and operations in the business and does not involve evaluation and comparison.
C. Incorrect. The function of controlling concerns the evaluation of all of the activities of the firm and the comparison of these activities with the desired objectives of the firm. The purpose, of course, is to locate sources of inefficiency in operations.
D. Incorrect. The planning function determines what shall be done, why it shall be done, how it shall be done and by whom and does not involve evaluation and comparison.

2. The disadvantages of the line organization can include:

A. Incorrect. The line organization is characterized by a vertical chain of command, running from a supervisor to his subordinates. It is simple to establish and clearly identifies sources of authority and responsibility. Because authority and responsibility are clearly identified, discipline is easily promoted.
B. Incorrect. Decisions are made quickly and efficiently since workers know definitely to whom they report, and thus shifting of responsibility is avoided.
C. Incorrect. Workers know definitely to whom they report to since the line of command run from the supervisor to his/her subordinates.
D. **Correct.** There are, however, several drawbacks to the line organization. The most serious drawback is the heavy burden of responsibility it places on the chief operating officer. Also, it creates little incentive to make decisions at lower levels and limits opportunities for promotion. Coordination and teamwork are restricted, since frequently divisions rival one another for the favor of the president or chief operating officer.

Chapter 4 Review Questions

1. The psychological factor that can be defined as the relative position a person has earned within the business only on past performance is:

A. **Correct.** Achieved status is the psychological factor that can be defined as the relative position a person has achieved within the business and is based only on past performance.
B. Incorrect. Ascribed status is attaining a position based on a factor other than past achievement. For example, if the son of the president of the firm suddenly emerges as a vice president, even though he has just joined the firm, he can be said to possess "ascribed status. It may be birth, race, sex, or any other non-earned factor.
C. Incorrect. Prestige is the recognition a person receives as a result of his status. Prestige can be recognized in several different ways. For example, the salary level of a worker may be an indication of the prestige and status of a worker.
D. Incorrect. Esteem is the regard a person is held by his peers and subordinates and superiors.

2. Leadership by delegation is:

A. Incorrect. Authoritative leadership is a centralized leadership. One person gives the order and expects it to be obeyed without question. There is no room for individual judgment, discussion of alternatives, or criticism. Authoritative leadership is most predominant in family-owned businesses, or closely held companies.

B. **Correct.** Much of the authority for decision making is delegated to subordinates, thereby sharing the leadership role. Although this type of leadership satisfies the psychological needs of many workers, it can also lead to problems. Productivity can decline if there is no one individual to act as "leader" and encourage the others to excel at their work.
C. Incorrect. Indirect leadership is leadership by or "free-rein" leadership is leadership by group; and it involves the delegation of authority for leadership to groups within the company. The technique of "sensitivity analysis" is to some extent founded on this concept. Sensitivity analysis itself revolves around small group meetings where a high level of individual participation and involvement takes place.
D. Incorrect. Free-rein leadership is leadership by group involvement. The goal of sensitivity training is to increase a person's awareness and knowledge about personal and interpersonal factors that influence the behavior of individuals. The concept of indirect leadership or free reign becomes apparent in sensitivity training in the small group meetings, where problems are placed before the group, and leadership is assumed by one or more individuals in the group.

Chapter 5 Review Questions

1. A strike waged by members of other unions as a show of support for a union that has called for a formal strike against a company is a

A. Incorrect. A workout strike is symbolized by workers walking away from their jobs "en mass".
B. Incorrect. A slowdown strike is an informal strike characterized by a sudden reduction in output by the working force.
C. **Correct.** A sympathy strike waged by members of other unions as a show of support for a union that has called a formal strike against a company.
D. Incorrect. A wildcat strike is a spur of the moment strike without the approval or knowledge of the national union.

2. Organized labor is adamantly opposed to the provision of regulation in the Taft-Hartley Act known as:

A. A is incorrect because collective bargaining involves both labor and management representatives' right to discuss their differences and not regulation of labor.
B. Incorrect. Mediation is the use of a disinterested third party to help resolve the dispute between both parties.
C. **Correct.** Organized labor is adamantly opposed to the "right-to-work" laws. It was legislated in the Labor-Management Relations (Taft-Hartley) Act-1947. In reaction to what was felt to be excessive power of the unions, this act basically amended the Wagner Act and tried to restore a balance of bargaining power between labor and management. It placed restrictions on unions.

D. Incorrect. Arbitration is a course of action to resolve the management/labor disputes.

Chapter 6 Review Questions

1. Mass Production is volume production of products with identical characteristics or specifications that does NOT include:

A. **Correct.** Research and development is new product development limited to test samples or sample products. Mass production is volume production of products that have identical characteristics or specifications. It is repetitive production on a large scale. Mass production is characterized by (a) mechanization (b) large-scale operations (c) standardization.
B. Incorrect. Mass production is characterized by mechanization.
C. Incorrect. Large scale operations are a major feature of mass production. It is repetitive production on a large scale.
D. Incorrect. Through standardization of the items produced, a repetitive production process on a mass scale is made possible.

2. The decision on the type of building will consider:

A. **Correct.** The decision on the type of building will consider the efficient movement of material and production throughout the plant. For large-scale operation, we have developed large factories in which mass production can occur. Through standardization of the items produced, a repetitive production process on a mass scale is made possible.
B. Incorrect. Analytical production involves the process of separating raw material into more basic parts.
C. Incorrect. Synthetic production assembles a product from its basic parts.
D. Incorrect. Fabrication process involves the formulation of consumer and industrial goods.

Chapter 7 Review Questions

1. The percentage of the cost of manufacturing a product related to the purchasing function is:

A. Incorrect. Purchasing is a function of business where over 50 percent of the cost of manufacturing a product is related to the purchasing function.
B. Incorrect. 2% is way too low for manufacturing function to be accomplished.

C. Incorrect. Over 50% of the cost of manufacturing a product is related to the purchasing function.
D. **Correct.** Purchasing is a function of business where over 50 percent of the cost of manufacturing a product is related to the purchasing function. By definition, purchasing involves acquiring the proper amount of materials to be used in the manufacture of finished products. The "right" amount must be delivered at the "right" time to the "right" place. A breakdown in any one of these steps can nullify all the cost savings realized in the other steps.

2. Purchasing agents seldom buy at:

A. Incorrect. Trade discounts are discounts offered by a supplier to purchasers as a matter of policy. Under the Robinson-Pitman Act, suppliers are forbidden from discriminating among purchasers in offering these discounts. That is, all purchasers of goods are entitled to the same trade discount that was offered to all other purchasers of the same class.
B. Incorrect. Quantity discounts are discounts offered to purchasers of large amounts of the item. Such discounts are justified because large purchases relieve the supplier of storage problems, and also tend to increase his profitability. Usually, these discounts are open to negotiation.
C. **Correct.** Purchasers buy large amounts at quantity discount prices. Purchasing agents seldom buy at list or retail prices, and therefore discounts offered by suppliers are a factor in their selection. There are three main kinds of discounts: trade, quantity, and cash.
D. Incorrect. Cash discounts are discounts offered to purchasers as an incentive for quick payment for the merchandise acquired. Cash discounts are usually offered to all purchasers, although the terms may vary considerably.

Chapter 8 Review Questions

1. Community factors that determine a good plant site may include:

A. **Correct.** Community factors that determine a good plant site may include the supply of workers. The supply of workers available at any location is vital to any labor-intensive industry. For certain companies, the question of a work force extends beyond the mere availability of workers; it also concerns the quality of the available work force and the union position within the community lacking skilled workers or workers who can be trained for skilled jobs.
B. Incorrect. The nearness to the market is a geographic factor and not a community factor. The nearness to its markets can be of great importance to a firm, since proximity to market enables a business to give better service and reduce transportation costs.
C. Incorrect. Favorable climate is a geographic factor and not a community factor. Although companies engaged in making products affected by climatic conditions will tend to locate where

climate is a favorable factor, this is not as important as it once was. This is because air conditioning can make it possible to manufacture products sensitive to heat and humidity even in subtropical Florida or the Deep South.

D. Incorrect. Availability of low cost power is a geographic factor. The availability of power and power supplies can be a critical factor for many large companies. Industries engaged in the manufacture of aluminum, for example, find that the factors of power supply to be the critical factor in determining where they will locate.

2. Customer characteristics that can play an important role in their buying choices will not include:

A. **Correct.** Area competition is not a customer characteristic that can play an important role in their buying habits because it is a location factor. The extent of the competition at a location is a vital consideration. An area already being served by a dozen carry-out restaurants might not be able to support another.
B. Incorrect. People with low incomes and lower social status will have buying patterns differing in many respects from those of customers with high incomes.
C. Incorrect. People with low or little education, and lower social status will have buying patterns differing in many respects from those of customers with high incomes, higher educational and occupational levels. Stores catering to particular national or racial groups must take these factors into account in making a location decision.
D. Incorrect. It is a customer characteristic. Buying patterns differ among customers with different social statuses. It is known, for example, that buying patterns differ among people living in large cities, rural areas, and the suburbs. People in different parts of the country, despite the tendency for differences to lessen, still have preferences for different products. Some companies specialize in status products such as jewelry, expensive cars, estates, fur coats and high end food products.

Chapter 9 Review Questions

1. The retrieval of raw data from the environment and delivering it to the computer is called:

A. Incorrect. Storage is information saved for future use.
B. Incorrect. Output is the information displayed to the end user.
C. **Correct.** The retrieval of raw data from the environment and delivering it to the computer is called input. Users can retrieve data as input of application software and produce information as output. If data are not accurate, the information produced will not be useful. Therefore, the garbage in, garbage out (GIGO) syndrome should be avoided.

D. Incorrect. Process is the manipulation, refining and processing of data to produce useful information.

2. Computer's that are designed to support a computer network that allows users to share files, applications, and hardware resources are:

A. Incorrect. Personal computers are designed for individuals.
B. **Correct.** Server computers are designed to support a computer network that allows users to share files, applications, and hardware resources. A server computer is normally used to serve other computers in the network in terms of file storage and resources management, data communications, printing management, and other computer functions.
C. Incorrect. Tablets are small, individual computers with screen-based, touch interaction where the keyboard and mice are optional devices input devices.
D. Incorrect. Mainframe computers are large computer systems that handle hundreds of users and store and process transactions at high speed.

Chapter 10 Review Questions

1. The balance sheet is a statement that is made up of all the following EXCEPT:

A. Incorrect. Owner's equity is one section of the balance sheet. It is also referred to as proprietorship, net worth or capital.
B. Incorrect. Assets are one section of the balance sheet. The assets of the firm comprise all items, both tangible and intangible, that are generally considered properties or rights of the company. These assets can be divided into three primary categories: (a) current assets, (b) intangible assets, and (c) fixed assets.
C. C Liabilities is incorrect. Liabilities are one section of the balance sheet. Liabilities generally are debts owed by the business firm to others. Typically, liabilities are of two types, current and long-term.
D. **Correct.** The balance sheet includes assets, liabilities and owner's equity. Revenue is not included because it is reflected in the income statement.

2. After deducting the operating expenses from the gross income in the income statement, the resulting figure is called:

A. Incorrect. Revenue is the major source of income. From the gross revenues, all product returns and sales cancellations and allowances are made.

B. Incorrect. Cost of goods sold comes from purchases in the current accounting period and left over inventory in the preceding period.
C. **Correct.** After deducting the operating expenses from the gross income in the income statement, the resulting figure is called net income or loss from operations. To this is added “other non-sales revenue" and from it is deducted "other non-sales related expenses."
D. Incorrect. Other income/expenses usually consist of interest earned on bond interest/expenses.

Chapter 11 Review Questions

1. Primary data may be collected from the following sources:

A. Incorrect. Business newspapers are secondary sources of data. Secondary sources must, of course, be carefully evaluated as to their accuracy and applicability to the problem. Nonetheless, such data are widely used because they are readily available.
B. Incorrect. Journals are secondary sources of data. Non-governmental sources include numerous business newspapers, journals, and magazines; trade association publications; statistical source books; press releases; and many other sources.
C. **Correct.** Primary data are derived from a designed study using sampling techniques. Primary data are those derived from a study designed specifically for the problem at hand.
D. Incorrect. Standard references are secondary sources of data and are more available and are less costly to obtain. Secondary data are accessible in numerous governmental publications-public documents and reports, census publications, and standard reference sources such as the Statistical Abstract of the United States and, Survey of Current Business.

2. A frequency distribution that gives the score in the frequency distribution that occurs most often is the:

A. Incorrect. The median is the central score in the array when arranged from lowest to highest.
B. **Correct.** The mode is the score in the frequency distribution that occurs most often.
C. Incorrect. The mean or average is the total of all values divided by the number of items.
D. Incorrect. The range is the spread between the smallest and the largest item in an array.

Chapter 12 Review Questions

1. Short-term funds can include:

A. Incorrect. Debt financing is used for long-term financing and not short-term financing. The most common form of debt financing is through issuing bonds. In doing so, several considerations must be kept in mind: (a) since the loan is only for a specified period, at some future date the debt must be repaid. (b) Because of the size of the probable bond issue, the way in which the bonds are retired is important. Considerations of such things as a serial retirement plan (in which bonds are retired or paid off according to a serial number printed on each bond), or sinking fund retirement plan, must be made. (c) As with any debt financing, the use of bonds means the payment of periodic interest.
B. Incorrect. New owner's funds are used for long-term financing. Corporate financing can provide new funds from owners which can be of two types. The company may issue preferred stock or it may issue common stock. The types differ in their legal status and in the terms underlying their issue.
C. **Correct.** Sources of short-term funds include the following: (1) normal trade credit, (2) bank credit, (3) borrowing from private sources or financial institutions on the basis of promissory notes, (4) sale of commercial paper, (5) factoring of accounts, (6) use of drafts, (7) trade acceptances, (8) issuance of chattel mortgages, and acquiring collateral that may be used to secure loans through (9) bills of lading and (10) warehouse receipts.
D. Incorrect. Internally generated sources are used for long-term funding. These sources include funds earned and retained by the company.

2. A clause in the indenture agreement giving the issuing company the right to call in or retire bonds in advance of the stated maturity date is the:

A. **Correct.** The call option is a clause in the indenture agreement giving the issuing company the right to call in or retire bonds in advance of the stated maturity date. It is a clause in the indenture agreement giving the issuing company the right to call in, or retire, bonds in advance of the stated maturity date. The option usually requires that the company pay a premium for this privilege.
B. Incorrect. A sinking fund is a steady accumulation of cash used to pay off an outstanding debt. Modern sinking fund arrangements allow the sinking fund trustee to use the periodic payments into the sinking fund to purchase the bonds in the open market and retire them.
C. Incorrect. The serial plan requires all outstanding bonds to carry a serial number that serves as the order of retirement orders starting from first issues being retired first. This number then serves as the indicated order of retirement; those bonds issued first are the first retired, and so on.
D. Incorrect. Owner's stock is common stock or preferred stock. Preferred stock is a form of equity financing that very much resembles a bond issue. Like a bond, preferred stock carries a stipulated and usually fixed rate of return (the preferred dividend). Common stock represents the residual ownership in the corporation. This is the voting stock, and it carries with it residual claims on profits and assets of the firm. It has no guaranteed dividend, cannot be converted into any other security.

Chapter 13 Review Questions

1. One of the basic elements of managerial control is:

A. Incorrect. Time-series projection is a method of forecasting.
B. Incorrect. Least-squares method is a statistical method of estimating business and economic variables.
C. **Correct.** One of the basic elements of managerial control is the measurement of performance. Managerial control can be thought of as comprising three basic elements: (1) the establishment of standards, (2) the measurement of performance, and (3) the analysis and correction of variations from the expected or forecasted results. For a business firm to compete successfully in today's world, its management must be able to control problems: controlling product-cost relationships within the firm and anticipating product-cost influences external to the firm.
D. Incorrect. Simulation model is a method of analyzing “what-if” scenarios.

2. One of the most important results of a sales forecast is the development of the:

A. Incorrect. Cash outflows or expenditures are only a part of forecasting and not the most important result.
B. **Correct.** One of the most important results of sales forecast is the development of the cash budget. The cash budget is a statement showing expected cash inflows (receipts) and expected cash outflows (expenditures).
C. Incorrect. Cash inflow or receipts are only a part of forecasting and not the most important result.
D. Incorrect. Cash surplus is only a part of forecasting and not the most important result.

Chapter 14 Review Questions

1. The two major institutions that guide financial institutions in setting their policies are the US treasury and:

A. Incorrect. The banks’ policies are guided by the US Treasury and the Federal Reserve System. Basically, the Fed operates as a "banker's bank," providing member banks with currency, clearing checks for them, and granting loans to member banks when conditions so warrant. At the same time, the Fed acts as an agent for the U.S. Treasury, assisting primarily in the orderly disposition of the large number of government securities that are sold and redeemed daily in the open market.

B. Incorrect. The savings and loan associations' policies are guided by the US Treasury and the Federal Reserve System. Savings and loan associations operate in much the same manner as commercial banks, except that the bulk of their loans (and, therefore, their major contribution as a financial institution) goes to the financing of mortgages on real estate. The savings and loan associations have been a vital source of funds for the construction industry in this country, and today rank among the largest financial institutions in the country.
C. Incorrect. Life insurance companies' policies are guided by the US Treasury and Federal Reserve. The second largest financial institution is the life insurance company. The source of funds for this institution is the premiums paid in by policyholders of life insurance. To provide the funds necessary to meet future claims on these policies, the insurance companies invest this money in securities and loans. The most significant differences between the life insurance companies and the commercial banks lie in the type and degree of governmental regulation, and in the length of maturities in which each can invest.
D. **Correct.** The two major institutions that guide financial institutions in setting their policies are the US Treasury and the Federal Reserve System. The Federal Reserve System is a quasi-public institution designed to facilitate the orderly growth of our economy and the maintenance of stable prices. Established in 1913, the Fed, as it is known, is comprised of 12 regional banks, the management of which consists of persons appointed by the local banks that are members of the System, and by appointees of the Board of Governors of the Federal Reserve System.

2. An example of a primary investment investor expert that provides the management of funds is

A. **Correct.** An example of a primary investment institution is the investment banker. The investment banker is a financial expert who assists corporations in determining the type, size, and amount of securities they will issue in their quest for capital. On occasion, the investment banker may know in advance of potential institutions that are interested in certain types of securities and can arrange a private placement-that is, a sale of the securities directly from the corporation to the institution. For this service he also receives a fee.
B. Incorrect. Commercial banks are involved in secondary market activities and not primary. Much of the lending power of commercial banks stems from the fractional reserve system in operation for these institutions. This system allows commercial banks to keep only a "fraction" of their total deposits on reserve as backing for potential withdrawals. The remainder of the deposits can be loaned out, thereby creating deposits in other banks throughout the country.
C. Incorrect. Savings and loan associations are involved in secondary market activities. Savings and loan associations operate in much the same manner as commercial banks, except that the bulk of their loans go to the financing of mortgages on real estate. The savings and loan associations have been a vital source of funds for the construction industry in this country, and today rank among the largest financial institutions in the country.

D. Incorrect. Mutual savings banks are not a significant factor in the total picture of financial institutions but are worth noting, since they represent a cross between the savings and loan associations and the commercial bank. They are owned by the depositors, rather than by stockholders. The bulk of their loans go to financing of real estate mortgages, much as with savings and loan associations. The only significant difference is that the mortgages financed by mutual savings banks are usually commercial mortgages, whereas savings and loan associations finance a large number of residential mortgages.

Chapter 15 Review Questions

1. A group of investment bankers that have joined together in a short-term project is known as:

A. Incorrect. The New York Stock Exchange is a group of members that buy, sell and trade stocks and bonds.
B. Incorrect. The American Stock Exchange is a group of members that buy, sell and trade stocks and bonds and commodities.
C. **Correct.** A group of investment bankers that have joined together in a short-term project is known as a syndicate. Frequently, a group of investment bankers will join together in as an investment banking group formed for a specific, short-term project. If the investment banker decides the firm's securities can be sold to prospective buyers without undue difficulty, it may underwrite the issue, that is, pay the issuing company the full value of the securities being issued, thereby assuming full responsibility for their sale.
D. Incorrect. The Mid-West Stock Exchange is a group of members that buy, sell, and exchange stocks and bonds and commodities.

2. Commodities are classified as all the following EXCEPT:

A. Incorrect. Commodities include in their classification all types of grains.
B. Incorrect. Livestock is included in the classification of commodities traded on the exchanges.
C. **Correct.** Commodities are classified as grains, feeds, livestock, food, fibers and metals. The commodity markets are the markets in which grains, feeds, livestock, foods, fibers, metals, etc., are bought and sold. The basic markets exist in commodity trading. One of these is the spot, or cash market. The other is the futures market. The spot market is used primarily by suppliers and users of the actual commodities in question. Farmers use the spot market when selling grains, and baking firms (like Pillsbury) use the spot market for buying the grain that is eventually turned into flour. In contrast, the futures market involves the purchase and/or sale of contracts calling for delivery at some date in the future. Most investors, or speculators, trade in the futures market.

D. Incorrect. Metals are traded on the commodity exchanges.

Chapter 16 Review Questions

1. One of the three basic types of individual life insurance policies is:

A. Incorrect. Casualty insurance is for financial losses. Casualty insurance covers a wide range of financial losses, but the most common are: (a) automobile collision insurance, (b) automobile liability insurance, (c) theft, (d) public liability insurance, (e) workmen's compensation, and (f) accident and health insurance, collision insurance, and theft. A business also needs to have these policies,
B. **Correct.** One of the three basic types of individual life insurance policies is term insurance. There are three basic types of individual life insurance policies: (1) term insurance, (2) whole life insurance, and (3) endowment life insurance.
C. Incorrect. Workman’s compensation is employer’s liability coverage against employee injury. Every state in the union has passed laws creating systems for workmen's compensation. These have redefined employer's liability and have provided for insurance coverage to protect employees against losses due to injury while in the employ of a company.
D. Incorrect. Fire insurance is protection against losses from fires or lightening. The standard fire insurance policy provides specialized protection against losses caused by fire or lightning. Since a large portion of all property loss claims are related to fire losses, this insurance is treated separately. Usually, fire insurance does not cover damage caused indirectly by fire. That is, losses resulting from a business' inability to continue operating immediately after a fire.

2. An insurance policy that each party to an accident is reimbursed by his/her own insurance company is called:

A. **Correct.** Under 'no-fault' policies, each party to an accident is reimbursed by his or her own insurance company, thus alleviating the need for lengthy and costly lawsuits in the settlement of claims. Only time will tell if 'no-fault' insurance can effectively lower the total cost of insurance to the consumer.
B. Incorrect. Ocean marine insurance protects against losses at sea. Marine insurance is of two types: (a) ocean marine, and (b) inland marine. Ocean marine insurance protects against losses resulting on the high seas. Inland marine insurance covers losses caused via all modes of transportation--so long as it is internal to the nation.
C. Incorrect. Inland marine insurance protects against all modes of transportation losses with in the nation.

D. Incorrect. Accident and health insurance covers illness and accidents usually designed to protect employees in s particular company.

Chapter 17 Review Questions

1. Buying motives that are classified as rational and economic include:

A. Incorrect. Satisfaction of the senses is an emotional motive. Emotional motives are characterized primarily by lack of logical reasoning on the part of the consumer. These are basically subjective in nature and are often made impulsively. Among the reasons for such buying behavior are the impulse to "keep up with the Joneses," a desire for status, and a desire for additional comfort or pleasure.
B. Incorrect. Marketers have made lists of emotional buying motives based on various aspects of human needs. One such list might include: (1) satisfaction of the senses, (2) preservation of the species, (3) fear, (4) rest and recreation, (5) pride, (6) sociability, (7) striving, and (8) curiosity or mystery.
C. **Correct.** Buying motives that are classified as rational and economic include the outstanding quality of a product. Rational or economic motives are those stemming from the buyer's logical reasoning and desire to make the best use of the available funds. For the most part, such motives are exhibited when a consumer buys products because: (a) knowledge on the part of the consumer convinced him the product in question was of outstanding quality, or (b) some logical consequence would probably occur as a result of the purchase that would enhance the long term goals of the consumer.
D. Incorrect. Fear is an emotional motive. Marketers take advantage of human fears and sell products to safeguard families, from fire, crime, and other disasters.

2. In marketing, the function that concerns the acquisition of materials that are used in the production of a product to be sold to the ultimate consumer is the:

A. A is incorrect because the transportation function involves moving the goods from the place of production to the ultimate place of sale and is not the acquisition of materials.
B. B is incorrect because the risk function assumes loss from obsolescence, fire, flooding, etc. and is not the acquisition of materials.
C. **Correct.** This function concerns the acquisition of the materials that are used in the production of the product or products that are to be sold to the ultimate consumer. While the buying function occurs at all levels of business activity, the most important aspect concerns the buying of raw materials for use in manufacturing.

D. Incorrect. The standardization function is the packaging of goods to facilitate transportation and resale.

Chapter 18 Review Questions

1. Merchants who purchase goods and take title of the goods from producers and wholesalers with the intent to resell them to the ultimate consumer are:

A. Incorrect. Merchant agents act as agents for producers and do not take title to the goods.
B. **Correct.** Retailers are middlemen who specialize in selling merchandise to the ultimate consumer. In many ways, this is the most critical stage in the entire marketing cycle, since it is at this point that goods face either acceptance or rejection by the consumer they were intended to please. Retailing institutions have undergone many significant changes over time, just as the consumer population has changed its buying habits and living habits.
C. Incorrect. Brokers primarily bring buyers and sellers together and do not usually deal with the ultimate consumer.
D. Incorrect. Manufacturer's agents are typically representatives of several producers selling on a commission basis within a select territory.

2. Stores that sell complete lines of one or two products only are known as:

A. Incorrect. Supermarkets are large grocery stores with large sections of products and are not limited to one or two product lines.
B. Incorrect. Department stores are characterized by a wide variety of goods and are not limited to one or two product lines.
C. Incorrect. Discount houses are like large department stories with a wide variety of products at low prices and are not limited to one or two product lines.
D. **Correct.** Stores that sell complete lines of one or two products only are known as specialty shops. Specialty shops are very popular today, particularly with the growing desires of people to express their individuality in the products they purchase. Such stores can cater to this desire, since they specialize in one, or perhaps two particular products, and carry virtually a complete stock of merchandise within these product lines.

Chapter 19 Review Questions

1. Advertising defined as “a vehicle for transmitting an advertiser’s message in permanent written, printed or processed form direct to select individuals” is known as:

A. Incorrect. Transit advertising is ads appearing on public transportation vehicles.
B. Incorrect. Outdoor advertising is typically by billboards along roadsides.
C. **Correct.** Direct mail is defined as "a vehicle for transmitting an advertiser's message in permanent written, printed, or processed form, direct to selected individuals." It need not necessarily be mailed. The more personal appeal of direct-mail advertising is one of its primary distinctions and is a reason for its continued popularity. It delivers its message on a selected, individual, rather than a mass, basis.
D. Incorrect. Radio advertising is directed to local populations. Most radio programming is local, but some network programs have a national audience. And while it may be common to think of radio as a dying medium, there are usually several radios in the typical American home and in almost every automobile. Teenagers, housewives, and sports fans all can be reached through radio advertising as they listen at various times of the day to their programs.

2. One of the disadvantages of advertising is:

A. Incorrect. The responsible success of mass production techniques is an advantage. Proponents of advertising claim that advertising (a) is responsible for the successful adoption of mass-production techniques in our country. (b) stimulates production and employment by inducing people to buy the merchandise being offered for sale; (c) is responsible for stimulating a competitive attitude in our economy, and thereby is indirectly responsible for the introduction of new products and better products for the consumer; and (d) educates the consumer as to the availability of new products and of new uses for old products. Taken together, these arguments make a strong case for the virtues of advertising.
B. **Correct.** One of the disadvantages of advertising is it stimulates a demand for goods that have little economic value. Critics claim that advertising (a) frequently causes the consumer to purchase goods that, in reality, he neither needs nor can afford; (b) creates demand for goods that have little economic value, the intent being to give companies something to produce for sale; (c) is often useless in that frequently sales of goods would be just as high without all of the advertising; (d) frequently costs so much that products cost more than they would if they were not advertised; (e) frequently is in poor taste, and is an insult to the intelligence of the consumer; and (f) is often misleading and prone to exaggeration as to the quality of goods.
C. Incorrect. The stimulation of production and employment is an advantage. It improves the economy through the sale of new products and increased employment opportunities.
D. Incorrect. Educating the consumer is an advantage. It makes the consumer aware and knowledgeable about new products and better products.

Chapter 20 Review Questions

1. The selling technique that has the ability to distinguish a potential customer from a non- customer is:

A. **Correct.** The selling technique that has the ability to distinguish a potential customer from a non- customer is prospecting. To some extent, the salesman's job is simplified because of the concept of market segmentation, that is, the designing of a product to appeal to a certain segment of the total market. Knowing this market can simplify the salesman's job of identifying his customers.
B. Incorrect. Planning is the organization of the promotional pitch preceding the sales pitch. Before actually calling on the prospect, the salesman must spend some time planning his promotional pitch. Only after doing so does he proceed to deliver his sales presentation, which consists of everything he does and says during the sales interview.
C. Incorrect. In all sales interviews, there comes a time when the prospect voices some objections. These may be based on natural sales resistance, a desire to get rid of the salesman, lack of sufficient money, or failure to recognize the benefits the product might have for him. The salesman must be able to overcome all these barriers for a successful conclusion to his selling effort.
D. Incorrect. The final step in the selling process is often said to be that of closing the sale. Once the customer has been convinced that the product offers something of value to the consumer, and that he really wants the product, it would seem that nothing is left but to close the sale. For some sales persons, this is the end of the cycle, but for others, hoping for return business, this may be only a step toward a continuing relationship. They may call on the customer time and time again, each time inquiring about the performance of the last product the consumer purchased. This is an excellent way to interest consumers in new products carried by the salesman.

2. Generally the best form of compensation for a sales person is:

A. Incorrect. Straight salary has limited incentive to increase sales and therefore is not the best form of compensation.
B. Incorrect. Commission creates an ethical problem for some salespeople that use high-pressure tactics that can damage the goodwill and reputation of a company.
C. **Correct.** Generally the best form of compensation for a sales person is salary and commission. The generally accepted best form of compensation is a form that blends qualities of the salary-plus-commission method of compensation. Under this system, the salesman is guaranteed a given salary, with the stipulation that sales in excess of a given amount will generate commission revenue for the salesman. Thus, the salesman is somewhat reluctant to misrepresent the product and company to gain a sale, since he may be jeopardizing his salary. Yet, if he is energetic and successful, the limited commission concept can reward him handsomely.

D. Incorrect. Fixed percentage of sales is similar to straight commission. When few sales occur or large times spent between sales exist they can create financial problems for the sales person.

Chapter 21 Review Questions

1. When one country can produce goods that another country cannot duplicate it is known as:

A. Incorrect. A cultural difference is an obstacle that can be overcome by learning the foreign country's customs. Culture can play an important role in international business and trade. This is particularly true in advertising and sales promotion. Ignorance of cultural taboos and manners and customs of a foreign country can create serious problems.
B. **Correct.** An absolute advantage exists when one country can produce goods that the other cannot duplicate. Yet, in the complicated trade relationships among countries, absolute advantages have very little importance. It is the comparative advantages which determine what products a country will export and what it will buy from another country.
C. Incorrect. An imposed barrier is a government regulation to restrict or set quotas on import goods that can often injure the prospect of international trade.
D. Incorrect. A language barrier can be overcome or duplicated by having the salespersons learn the foreign language or by hiring native speaking salespersons.

2. A certificate indicating title to goods in transit is:

A. Incorrect. A bill of exchange is a draft issued by the seller requesting the buyer to accept the offer and is not a certificate indicating title to the goods.
B. Incorrect. A commercial letter of credit states that the bank stands to honor the commitments and obligations of the buyer.
C. Incorrect. An insurance policy covers the cost of damages or losses as well as export and import licenses.
D. **Correct.** The bill of lading is a certificate indicating title to the goods in transit. This is usually sent by the seller to his bank. The bank releases the bill of lading when it is given the trade acceptance by the buyer. Also required as a matter of course are various insurance policies covering the goods, export and import licenses, and other documents that may be required by various governments.

Chapter 22 Review Questions

1. In order for a contract to be legal it cannot be:

A. Incorrect. A condition of a contract is that an offer must be made and accepted to be legal.
B. Incorrect. A contract must have consideration or remuneration to be legal.
C. **Correct.** In order for a contract to be legal it cannot be accepted by a minor because he/she is considered to be incompetent in the eyes of the law. In order for a contract to be enforceable, an offer must have been made and accepted, and consideration or remuneration for the services performed must have been agreed on. Also, two other conditions must be met before the contract is legally enforceable. First, the agreeing parties must both be competent people-in the eyes of the law. Under some instances, minors are not considered "legally competent: for the purpose of making contracts. Second, the contract itself must be lawful- a contract that involves a breach of the law is unenforceable.
D. Incorrect. A contract must have a competent person as the acceptor to be legal in the eyes of the law.

2. Legal aspects of business law applied to contracts, agencies and negotiable instruments will NOT include:

A. Incorrect. Sales contracts are included in the legal aspects of business law. A contract is an agreement between two or more parties in which one party agrees to perform some stipulated service and receive from the other party a fee or award for this service. Contracts are at the heart of the American business system-the whole realm of business depends on contracts between two or more parties.
B. **Correct.** The area of contracts, agencies and negotiable instruments are included in the legal aspects of business law along with sales contracts, agencies and negotiable instruments. Business ethics is not based on business law but on customs and ethical behavior. These judgments are influenced by what is considered to be right or wrong; that is, what activity is considered proper, honest, and fair, and what activity is not. This is referred to as ethics, or as applied to business decisions, business ethics.
C. Incorrect. Garnishment of wages is provided for in the legal aspect of business law. The areas of contracts, agencies, and negotiable instruments, while not the only aspects of business law, are certainly among the most important. Other areas of importance involve: (1) partnerships, (2) corporations, (3) sales contracts, (4) bankruptcy, (5) garnishment of wages, (6) liens, and (7) personal property.
D. Incorrect. Liens are provided for in the legal aspects of business law.

Chapter 23 Review Questions

1. The first piece of federal legislation to regulate the activities of railroads, set rate schedules and grant right-of-way is:

A. Incorrect. The Sherman Antitrust Act outlawed monopolization.
B. **Correct.** The first piece of federal legislation to regulate the activities of railroads, set rate schedules and grant right-of-way is the Interstate Commerce Commission Act of 1887. This act was intended to regulate the activities of the railroads, primarily, and did this by establishing an Interstate Commerce Commission which had the power to set rate schedules, grant rights-of-way, and in other ways direct the activities of the transportation industry. The power of the Interstate Commerce Commission has grown with time, however, and today its influence is felt in all areas of business, particularly interstate business.
C. Incorrect. The Federal Reserve System regulates monetary policy in the USA.
D. Incorrect. The Robinson-Patman Act is concerned with unfair marketing practices.

2. Taxes that are levied to restrict the flow of imports from foreign countries into the USA because they compete with American-made items are:

A. Incorrect. Excise taxes are levied against luxury items and not imports competing with American-made items. Excise taxes are specialized taxes that are levied, for the most part, against luxury items. Jewelry, guns, cameras, perfumes, and automobile tires are typical items that may carry an excise tax charge.
B. Incorrect. This tax is often levied on the purchases of all consumer goods. Some states, however, exempt food and drug purchases from this tax on the belief that they are necessities of life and therefore should not be taxed.
C. **Correct.** Taxes are levied to restrict the flow of imports from foreign countries into the USA because they compete with American-made items are custom duties. Custom duties are levies that, ostensibly, are designed to restrict the flow of imports into the country. These taxes are levied against imported goods, particularly goods that compete with American-made items. The tax is intended to reduce or remove the attractiveness of the foreign-made good and increase the marketability of the American-made good.
D. Incorrect. The corporate income tax is a tax levied against the income of all profit-making corporations. The tax rate is quite high, the result being that the corporate income tax is the second largest source of revenue for the government. This tax is levied only against corporations, with the income earned by partners and sole proprietors being treated as individual.