

## CHAPTER

# 4

# Business in the Free Enterprise

## Section 4.1

## Business in the Private Sector



How do different types of businesses serve different customers?

### Objectives

After completing this section, you will be able to:

- **Describe** three general types of business in the private sector.
- **Define** the North American Industry Classification System (NAICS).
- **Identify** three types of customers businesses serve.

## Section 4.1 Review

### Check Your Understanding

1. List three major types of business in the private sector.

**Answer:** Three major types of businesses in the private sector include producers, intermediaries, and service businesses.

2. What is the difference between businesses in the public and private sectors?

**Answer:** The difference between businesses in the public and private sectors is the purpose of the business. The purpose of organizations in the public sector is to serve the public. Businesses in the private sector generate revenue. The sole purpose of these businesses is to be productive and generate money for their owners.

3. Name two examples of intermediary businesses.

**Answer:** Wholesalers and retailers are the most common intermediary businesses.

4. Which countries collaborated to develop NAICS?

**Answer:** NAICS was developed by the United States, Canadian, and Mexican governments.

5. Identify the three categories of customers businesses serve.

**Answer:** Three categories of customers businesses serve are consumers, businesses, and government and institutions.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

for-profit business

**Answer:** Organization that generates revenue.

not-for-profit organization

**Answer:** Organization that exists to serve some public purpose.

producer

**Answer:** Business that creates goods and services.

extractor

**Answer:** Business or person that takes natural resources from the land.

manufacturer

**Answer:** Business that uses supplies from other producers to make products.

intermediary

**Answer:** Person or business that sells the goods and services from producers to customers.

wholesaler

**Answer:** Business that purchases large quantities of products directly from producers and sells the products in smaller quantities to retailers. Also known as a *distributor*.

retailer

**Answer:** Business that buys products from wholesalers or directly from producers, and sells them to consumers to make a profit.

service business

**Answer:** Business that earns profits by providing consumers with services that meet their needs and wants.

North American Industry Classification System (NAICS)

**Answer:** Numeric system used to classify businesses and collect economic statistics; pronounced *nākes*.

consumer market

**Answer:** Consists of customers who buy products for their own use.

business-to-consumer (B2C)

**Answer:** Business that sells primarily to individual consumers.

business market

**Answer:** Consists of customers who buy products for use in a business.

business-to-business (B2B)

**Answer:** Business that sells primarily to other businesses.

government market

**Answer:** Customers include national, state, and local government offices and agencies.

institution

**Answer:** Nonprofit organization that may be either public or private.

## Section 4.2

# Business Organization



How do business owners choose a form of ownership?

### Objectives

After completing this section, you will be able to:

- **Describe** the three basic forms of business ownership.
- **Explain** alternative ways a business can be organized.

## Section 4.2 Review

### Check Your Understanding

1. Identify the three basic forms of business ownership.

**Answer:** The three basic forms of business ownership are proprietorship, partnership, and corporation.

2. What is unlimited liability?

**Answer:** Unlimited liability means the business owner is held personally responsible for all debts and losses of the business.

3. List five details commonly found on a partnership agreement.

**Answer:** A partnership agreement should contain (any five) the date of the agreement, names of the partners, name and location of the business, nature of the business activity, duties of each partner, investment of each partner, division of profit and losses, plan for dissolving the partnership, and signatures of the partners.

4. What are some disadvantages of the corporation form of business ownership?

**Answer:** The disadvantages of corporations are that they are expensive to form, they have many government regulations, and double taxation.

5. List three alternative forms of business ownership.

**Answer:** Three alternative forms of business ownership are S corporation, limited liability company, and cooperative.

### Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

proprietorship

**Answer:** Business that is owned and often operated by a single individual.

liability

**Answer:** Legal responsibility.

partnership

Answer: Association of two or more persons who co-own a business with the objective of earning a profit.

partnership agreement

Answer: Written contract that establishes a partnership; also called the *articles of partnership*.

corporation

Answer: Business that is legally separate from its owners and has most of the legal rights of an actual person.

stock

Answer: Share of ownership in a corporation.

dividend

Answer: Portion of a corporation's earnings distributed to stockholders.

board of directors

Answer: Group of individuals who make high-level management decisions for a business and establish company policies.

limited liability company (LLC)

Answer: Form of business ownership that combines the benefits of a corporation with those of proprietorships and partnerships.

cooperative

Answer: Business that is owned and operated by those using its services; also called a *co-op*.

## Chapter Summary

### Section 4.1 Business in the Private Sector

- Three general types of businesses in the private sector are producers, intermediaries, and service businesses. Producers are businesses that create goods and services. Businesses that sell the goods and services directly to customers are called intermediaries. A service business provides consumers with services that meet their needs and wants.
- The North American Industry Classification System (NAICS) was developed to define the types of businesses and to gather and track trade data. NAICS was developed by the US, Canadian, and Mexican governments for trade purposes. NAICS codes are used to classify businesses based on their activities.
- A customer is an individual or group who buys products. Customers can be classified as consumers, businesses, and government and institutions. Businesses that sell primarily to individual consumers are in the business-to-consumer (B2C) market. Businesses that sell primarily to other businesses are in the business-to-business (B2B) market.

### Section 4.2 Business Organization

- Businesses can be structured in different ways. The number of owners and size of the business are important factors in determining the best form of ownership. There are three basic forms of business ownership: proprietorship, partnership, and corporation. Each form has unique advantages and disadvantages.

- Alternative forms of business ownership combine elements of proprietorships, partnerships, and corporations. These alternative forms include S corporations, limited liability companies, and cooperatives. Like other forms of ownership, each of these has advantages and disadvantages.

## Review Your Knowledge

1. Describe three general types of business in the private sector.

**Answer:** Three categories of businesses in the private sector are producers, intermediaries, and service businesses. Producers are businesses that create goods and services. Intermediaries are people or businesses that sell the goods and services from producers to customers. Service businesses earn profits by providing consumers with services that meet their needs and wants.

2. Describe the role of service businesses. Give an example of a service business.

**Answer:** A service business earns profits by providing consumers with services that meet their needs and wants. Service businesses do not sell products. These businesses perform activities and provide expertise for their customers. Examples of service businesses include moving companies, law firms, and interior design firms.

3. What is the purpose of the North American Industry Classification System?

**Answer:** The North American Industry Classification System (NAICS) is a numeric system used to classify businesses and collect economic statistics. This system was developed by the US, Canadian, and Mexican governments for trade purposes. Standard categories of businesses were developed to define the business types and to gather and track trade data. The codes are used to classify businesses based on the activity that takes place within each business.

4. Explain the difference between the consumer market and the business market.

**Answer:** The consumer market consists of customers who buy products for their own use. Consumers are actually the end users of the products. The business market consists of customers who buy products for use in a business. A customer in the business market is a business that buys products from another business.

5. Describe the three basic forms of business ownership.

**Answer:** A proprietorship is a business that is owned and often operated by a single individual. A proprietorship is the simplest and most common form of business ownership. A partnership is an association of two or more persons who co-own a business with the objective of earning a profit. Partnerships are businesses created for the purpose of earning a profit. A corporation is a business that is legally separate from its owners. It has most of the legal rights of an actual person, but exists only on paper.

6. What are some advantages and disadvantages of a proprietorship?

**Answer:** The advantages of proprietorships are it is easy to start and close, the owner retains all profits, the owner has complete control of operations, and there is a simple tax structure. The disadvantages are unlimited liability for the owner, limited business expertise, and a limited life of business.

7. Explain the difference between a general partnership and a limited partnership.

**Answer:** A general partnership is a business that is co-owned by two or more general partners who are responsible for business operations. General partners have authority to make decisions, are active in day-to-day business operations, and have unlimited liability for debts. A limited partnership is a business co-owned by at least one general partner and one or more limited partners. Limited partners invest money in the business but have no authority to make decisions.

8. Describe how corporations are established.

**Answer:** Articles of incorporation must be filed with the Secretary of State's office in the state of operation. The articles of incorporation must include the names of the corporation's founders, name of the corporation, and type of business that will be conducted. Corporate bylaws are then created to explain the practices and procedures to be followed in conducting business. The bylaws typically include the name and address of the business, the type of stock that will be issued, the number of shares of stock that will be issued, and procedures for stockholder meetings. Stockholders then elect a board of directors who make high-level management decisions for the business and establish company policies. The board of directors also selects a chief executive officer (CEO) and other corporate officers to run the day-to-day operations.

9. What are common guidelines that apply to naming an LLC business?

**Answer:** The name cannot be the same as an LLC that already exists in the state. The name must include LLC as part of its name. The name cannot include words prohibited by the state in which it is created.

10. Explain how the participation of members impacts the effectiveness of a co-op.

**Answer:** The participation of members in the activities of a co-op may depend on how much they use or benefit from the cooperative. The business cannot operate effectively if all members do not fully participate. If the co-op does not operate effectively and produce benefits for its members, it could lose members, which reduces the pool of resources available.

## Apply Your Knowledge

1. Make a list of four natural resources. Give examples of products that are created from each resource. What role do producers, intermediaries, and service businesses play in creating the products you listed?

**Answer:** Student answers will vary. Evaluate each response individually.

2. Create a chart listing ten businesses in your community. Identify which businesses are for-profit and which are not-for-profit. For each business, indicate if it is part of the public sector or the private section.

**Answer:** Student answers will vary. Evaluate each response individually.

3. Identify an example of a non-profit organization with which you are familiar. What services does this organization provide? How does this organization raise funds?

**Answer:** Student answers will vary. Evaluate each response individually.

4. Compare the forms of business ownership discussed in this chapter. What characteristics do they have in common? How are the ownership structures different? Create a chart that compares the features of the forms of business ownership.

**Answer:** Student answers will vary. Evaluate each response individually.

5. A group of students plans to start a delivery service. Which business ownership structure should they choose? Consider the size of the business, the type of business activities performed, and the number of owners. Write a paper explaining your answer.

Answer: Student answers will vary. Evaluate each response individually.



## You Do the Math

### Problem Solving and Reasoning

*Word problems* are exercises in which the problem is set up in text, rather than as a mathematical notation. Many word problems tell a story. You must identify the elements of the math problem and solve it. There are several strategies for solving word problems. Some of the common strategies include making a list or table, working backward, making a guess and then checking and revising, and substituting simpler numbers to solve the problem.

#### Solve the following problems.

1. An online bookseller must earn a profit of 27 percent on each book it sells. The bookseller's cost for each book is \$5.58. How much must the bookseller charge to make the required profit?

Answer:  $\$5.58 \times .27 = \$1.51$

$$\$5.58 + \$1.51 = \$7.09$$

The bookseller must charge \$7.09 to make the required profit.

2. A delivery service charges a fuel surcharge whenever the price of gasoline exceeds \$4.00 per gallon. The surcharge is 45 percent of the amount over \$4.00 for each gallon of gasoline used. The current price of gasoline is \$4.32 per gallon. If the price of the delivery service is \$6.95 and the driver uses 5.25 gallons of gasoline for the delivery, what is the total charged for the delivery?

Answer: Delivery charge = \$6.95

$$\text{Surcharge} = (\$4.32 - \$4.00) \times 45 = \$1.14 \text{ per gallon}$$

$$\$6.95 + (\$1.14 \times 5.25) = \$7.69$$

The total delivery charge is \$7.69

3. Avery Johnson owns a graphic design firm. He must price a job for a client. The labor cost is \$4,053 and the material cost is \$605. A 15 percent markup is added to the costs. Sales tax of 6.25 percent must be added to the materials cost. What is the total price Avery must quote to the customer?

Answer:  $\$4,053 \text{ labor} \times .15 \text{ markup} = \$607.95$

$$\$4,053 \text{ labor} + \$607.95 \text{ markup} = \$4,660.95 \text{ total labor}$$

$$\$605 \text{ materials} \times .15 \text{ markup} = \$90.75$$

$$\$605 \text{ materials} + \$90.75 \text{ markup} = \$695.75 \text{ total materials}$$

$$\$695.75 \text{ materials} \times .0625 \text{ sales tax} = \$43.48 \text{ sales tax}$$

$$\$4,660.95 \text{ labor} + \$695.75 \text{ materials} + \$43.48 \text{ tax} = \$5,400.18$$

The total price Avery must quote the customer is \$5,400.18.