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# Entrepreneurs in a Market Economy

**2.1** Entrepreneurs Satisfy Needs and Wants

**2.2** How Economic Decisions Are Made

**2.3** What Affects Price?



## Website Marketing

Have you ever wondered why certain websites come up when you use a web search engine such as Google or Yahoo? The results you get may be due to the work of Exclusive Concepts, Inc.

Scott Smigler, Exclusive Concepts founder and president, balanced dual roles as a student and an entrepreneur through high school and college. His company provides online marketing solutions by helping businesses stand out when someone uses a web search engine. Scott ran the company by himself in the beginning. Eventually, Scott moved from his home to his college dorm room to offices in Burlington, Massachusetts, and he now has a staff of 30. The company's estimated sales for a recent year were \$3 million.

Scott's ability to develop keyword strategies, write attention-getting keyword ad copy, create and optimize bidding strategies, and analyze results for continuous improvement helped him become a leader in the field. In addition to running the company, he maintained a 3.7 GPA as a finance major at Bentley University in Burlington, Massachusetts.

Some important lessons Scott has learned include these:

- **Perseverance** You must be organized and focused. Implementing dreams is not easy.
- **Mentorship** You need to have a network of mentors to help you with problems.
- **Communication** You need excellent communication skills; written agreements between your company and clients are essential.
- **Capitalization** You should be prepared for everything to be more expensive than you think and plan for unanticipated expenses.
- **Marketing** You must work to acquire new relationships while continuing to build existing ones. Everyone is a potential customer or client.

Scott also stresses the importance of finding the correct balance between work and play. Starting and running a business require focus, dedication, and time, but it is important to remember that there is life outside the business.

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Scott Smigler, Exclusive Concepts founder and president

1. What type of interests do you think Scott had that helped him find success in this business?
2. Which of the lessons that Scott has learned do you think is most important?
3. Why do you think it is important to find a balance between work and play?

what  
do you  
know?

# 2.1

## ENTREPRENEURS SATISFY NEEDS AND WANTS

### Goals

- Distinguish between needs and wants.
- Describe the types of economic resources.
- Explain the role of entrepreneurs in the U.S. economy.

### Vocabulary

- needs
- wants
- economic resources

## focus on Economics

### Do you *want* it or *need* it?

“Dad, I really need a new pair of shoes to wear to the Winter Dance,” said Stephanie. “Do you *need* a new pair of shoes, or do you *want* a new pair of shoes?” her father responded. “Want or need—what’s the difference?” Stephanie asked. “That’s a good question, Stephanie. Let’s look at it this way. Do you really need the shoes in order to survive, or will having the new shoes make you feel better?” asked her father.

Stephanie thought about it and then responded, “Well, Dad, it won’t keep me from going to the dance if I don’t have the new shoes, but I’d sure like to have them. So, I guess I’d have to answer you by saying they would make me feel better.” “Then you *want* the shoes, but you don’t *need* them!” her father responded. “That’s what economics is all about!”



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It is often difficult to distinguish between a want and a need.

**Work as a Team** Do you sometimes have a difficult time telling the difference between a need and a want? Do you think peer pressure makes it more difficult to distinguish between a need and a want?

### Is It a Need or a Want?

Think about your favorite piece of clothing, such as a pair of jeans. First, you thought about what type of clothing you wanted, and then you went out and found it. Maybe you looked at several articles of clothing and compared prices before you decided to spend your money. If someone else gave you clothing as a gift, then that person had to think about what you might like and then make a choice. Economics is all about making choices and satisfying the wants and needs of consumers.

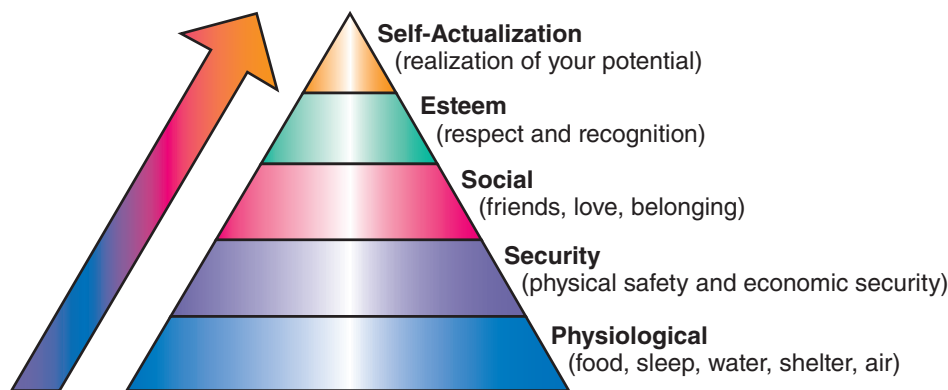
Do you know the difference between your needs and wants? Your **needs** are things that you must have in order to survive. Needs include food, basic clothing, and a place to live. Your **wants** are those things that you think you must have in order to be satisfied. Wants add comfort and pleasure to your life. Wants would include things like CDs, computers, and jewelry. The role of businesses is to produce and distribute goods and services that people need and want.

## DEVELOP YOUR READING SKILLS

As you read this chapter, develop an outline of the main topics. Write a short summary for each topic after you read it.

### Needs

People have many needs. Some are basic needs while others are higher-level needs. Abraham Maslow was a psychologist who developed a theory on the *hierarchy of needs*. It identifies five areas of needs—physiological, security, social, esteem, and self-actualization needs. The theory suggests that people’s basic physiological needs, such as food, clothing, and shelter, must be satisfied first before they can focus on higher-level needs. Once basic needs are met, people will try to satisfy their security needs. When these needs are filled, individuals turn their attention to social needs, such as friendship. Esteem needs can be satisfied by gaining the respect and recognition of others. Self-actualization needs usually involve something that provides a sense of accomplishment, such as earning a college degree.



**Maslow's Hierarchy of Needs Pyramid**

Beyond basic needs, not all people have the same needs. Needs depend on a person’s situation. You may live in a nice house in a gated community, so your security needs are met. Someone who lives in a high-crime area still may be trying to meet security needs.

### Wants

Individuals have two different types of wants—economic wants and noneconomic wants. *Economic wants* involve a desire for material goods and services. They are the basis of an economy. People want material goods, such as clothing, housing, and cars. They also want services, such as hair styling and medical care. No economy has the resources necessary to satisfy all of the wants of all people for all material goods and services. The goods and services that people want must be produced and supplied.

## NETBookmark

All businesses—from small, one-person operations to large corporations such as Walmart—exist to provide goods and services that people want and need. Access [www.cengage.com/school/entrepreneurship/ideas](http://www.cengage.com/school/entrepreneurship/ideas) and click on the link for Chapter 2. At the Walmart website, find two items that would satisfy a *need* of yours. Tell what need (physiological, security, social, esteem, or self-actualization) each product would satisfy. Then find one item that would satisfy a *want* of yours and explain why that item is not a need.

[www.cengage.com/school/entrepreneurship/ideas](http://www.cengage.com/school/entrepreneurship/ideas)

People also have *noneconomic wants*, or the desire for nonmaterial things. These wants would include such things as sunshine, fresh air, exercise, friendship, and happiness.

### Needs and Wants Are Unlimited

Your needs and wants never end. You are limited only by what your mind can think of and what businesses make available for sale. If you are going camping, you might need to buy a tent for shelter. One purchase often leads to another. After buying a tent, you might also want to buy other camping supplies. Then you might want a bigger backpack to carry your new supplies.

## CHECKPOINT

What is the difference between a need and a want?

## Economic Resources

**Economic resources** are the means through which goods and services are produced. *Goods* are products you can see and touch. *Services* are activities that are consumed as they are produced. Entrepreneurs use economic resources to create the goods and services consumers use. Consumers satisfy needs and wants by purchasing and consuming goods and services.

Goods are products you can purchase. A pair of shoes, a jacket, food, and cars are all examples of goods. Services must be provided to you at the time you need them—they cannot be stored. A haircut, a manicure, lawn mowing, and car detailing are all examples of services.

### Factors of Production

In order to create useful goods and services, an entrepreneur may use three types of economic resources. These resources are called the *factors of production* and include natural resources, human resources, and capital resources.



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What kind of resources are used for farming?

**NATURAL RESOURCES** Raw materials supplied by nature are *natural resources*. The earth contains oil, minerals, and the nutrients needed to grow crops and timber. Rivers, lakes, and oceans are the sources of both food and water. All products you use begin with one or more natural resources. The supply of many natural resources is limited. Increased use of natural resources and damage to the environment threatens the continued availability of natural resources in many regions of the world. Conservation practices and the production of more efficient products help to preserve and renew resources. Compact fluorescent light bulbs (CFLs) cost more than old-style incandescent bulbs, but they last longer, use far less electricity, save consumers' money in the long run, and reduce greenhouse gases. One CFL keeps a half-ton of greenhouse gases (CO<sub>2</sub>) out of the atmosphere. When consumers switch to CFLs, they help preserve energy resources and the environment for future generations.

**HUMAN RESOURCES** The people who create goods and services are called *human resources*. They may work in agriculture, manufacturing, distribution, or retail businesses. As an entrepreneur, you would also be a human resource. Entrepreneurs have creative ideas and use these ideas to create new goods and services.

To increase the productivity of human resources, business owners may use specialization and division of labor. *Specialization* occurs when individual workers focus on single tasks, enabling each worker to become more efficient and productive. Even though a worker may be talented at many things, when he or she specializes in performing one task, generally, more can be produced. *Division of labor* divides the production process into separate tasks carried out by workers who specialize in those specific tasks. This division of labor allows the group as a whole to be more productive.

**CAPITAL RESOURCES** The assets used in the production of goods and services are called *capital resources*. Capital resources include buildings, equipment, and supplies. They also include the money needed to build a factory, buy a delivery truck, and pay the employees who manufacture and distribute goods and services.

### Limited Resources

All economic resources have a limited supply. Most resources can be used to produce several different products and services. If resources are used to produce one type of product, they may not be available for the production of another product. Individuals, businesses, and countries compete for access to and ownership of economic resources. Those resources that are in very high demand or that have a limited supply will command high prices. Control of oil fields in the Middle East has been an ongoing issue for many years. The United States has a large demand for oil but a limited supply of oil, so it is important to the United States to have access to oil from the Middle East. This high demand contributes to high gasoline prices.

## Law of Diminishing Returns

To make the most efficient use of their resources, businesses should consider the law of diminishing returns. The *law of diminishing returns* states that if one factor of production is increased while others stay the same, the resulting increase in output (product produced) will level off after some time and then will decline. This means that extra workers, extra capital, extra machinery, or extra land may not necessarily raise output as much as expected. For example, increasing the number of workers (human resources) may allow additional output to be produced by using any spare capacity workers have, such as unused workspace or machinery (capital resources). Once this capacity is fully used, however, continually increasing the number of workers without increasing the workspace or number of machines will not result in an increase of output.

### CHECKPOINT

List the three types of economic resources and give an example of each.

## Role of Entrepreneurs in the U.S. Economy

Entrepreneurs play an important role in the U.S. economy. Because all businesses that exist in the United States today began as an entrepreneurial idea, you could say that entrepreneurs are the backbone of the U.S. economy. The development and growth of small businesses help to ensure a strong economic future.



Digital Vision/Getty Images

How do entrepreneurs help meet the demands of consumers?

### Supply and Demand

As business owners, entrepreneurs play an important role in supplying goods and services to meet the demands of consumers. They continually look for unmet needs or better ways to satisfy consumers' needs and wants. They use resources and their knowledge of markets and business to produce goods and services efficiently that meet consumers' needs and wants.

### Capital Investment and Job Creation

Entrepreneurs need money to finance their businesses. Sometimes they use their own money. Other times, they look to investors and lenders to supply the money they need. They may use the money to lease a building, buy equipment, or hire employees. By doing so,

entrepreneurs are investing in their communities by contributing to the local economy and providing jobs.

## Change Agents

Many entrepreneurs create products that change the way people live and conduct business. When you learn about American history, you see that many entrepreneurs have shaped the U.S. economy.



## CHECKPOINT

What are some things entrepreneurs contribute to the U.S. economy?

## 2.1

## ASSESSMENT

### THINK ABOUT IT

1. What role do needs and wants play in determining what is produced in an economy?
2. How does the availability of economic resources affect an entrepreneur's decisions?
3. Which of the contributions to the U.S. economy that entrepreneurs make do you think is most important? Why?

### MAKE ACADEMIC CONNECTIONS

4. **SOCIAL STUDIES** Think of a business in your area. Make a list of the resources that the business uses for each factor of production.
5. **RESEARCH** Investigate and analyze the specialization and division of labor used by a business in your area. Write a paragraph explaining the impact of specialization and division of labor on the company's productivity.
6. **HISTORY** The needs of people in today's society vary greatly from the needs of people living a century ago. Conduct online research to learn about the life of the typical person living during that time period. Compare that person's needs with the needs of someone living today. Write a short report describing the differences and similarities.

### Teamwork



Working in a team, make a list of the natural resources in your area. Using the Internet, almanacs, and other sources of information about your community, find out the impact these resources have on your local economy. Which businesses use these natural resources?



# 2.2

## HOW ECONOMIC DECISIONS ARE MADE

### Goals

- Compare and contrast different types of economic systems.
- Describe the characteristics of the U.S. economy.
- Explain how scarcity affects economic decisions.
- Explain how business functions are used to satisfy consumers.

### Vocabulary

- capitalism
- profit
- economic decision making
- scarcity
- opportunity cost

## focus on Economics

### Choose between alternatives.

“Stephanie, weren’t you thinking about buying a new MP3 player last week?” her dad asked. “Yes, Dad, I was,” Stephanie replied, “but if I buy the new shoes I want for the Winter Dance, I won’t have enough money to buy the MP3 player now.” “You’ve just learned a lesson about opportunity cost. When you choose one item over another, the opportunity cost is the value of the item you give up—in this case, the MP3 player,” her dad explained. “I understand, Dad. But if you took this opportunity to buy the shoes for me, then I wouldn’t have any opportunity cost, would I?”

**Work as a Team** Discuss choices that you have made. Did you realize that in choosing one item over another there was an opportunity cost?



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You often have to choose one option over another.

## Economic Systems

Different economic systems exist throughout the world. However, all economies must answer three basic questions.

1. What goods and services will be produced?
2. How will the goods and services be produced?
3. For whom will the goods and services be produced (in other words, whose needs and wants will be satisfied)?

If all economies struggle with the same basic questions, what is it that makes economies different? The type of economic system will determine how these three economic questions are answered. Economies must choose a way to allocate the goods and services that are available to the people who need or want them. These different allocation processes are what create different economies.

## Command Economy

In a *command economy*, the government determines what, how, and for whom products and services are produced. Because the government is making the decisions, there is very little choice for consumers in what is available. The government may see no reason to have more than one type of the same item. This means individuals may not always be able to obtain exactly what they want. There will be shirts and pants, but there will not be many styles and colors from which to choose.

## Market Economy

Market economies are about personal choice. In a *market economy*, individuals and businesses decide what, how, and for whom goods and services are produced. Entrepreneurship thrives in a market economy. Decisions about production and consumption are made by millions of people, each acting alone. Individual choice creates the market, so there are many items available that are very similar. If a product sells, it will remain on the market. If not, the manufacturer will not continue to produce it.

Individual choice also exists in how items are produced. A furniture maker will make choices regarding the style, fabric, and durability of products made. In addition, products and services are always available to everyone who has the means to pay for them.



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How does a country's economic system affect consumers' product choices?

## Traditional Economy

Before complex economic systems developed, simple economies operated according to tradition or custom. In a *traditional economy*, goods and services are produced the way they have always been produced. The traditional economy is used in countries that are less developed and are not yet participating in the global economy. Most of what is produced is consumed, and what is left over is sold or traded with people who live in nearby communities. Traditional economies lack the formal structure found in more advanced economic systems and usually have limited capital resources available to improve their conditions.

## Mixed Economy

When elements of the command and market economies are combined, it is called a *mixed economy*. A mixed economy often results when a country shifts away from a command economy toward a market economy but still has government involvement in the marketplace. Many countries are making this shift.

For over 70 years, the Soviet Union operated under a command economic system called *communism*. Government control resulted in limited choices and a shortage in supply of many consumer goods.

The Soviet Union disbanded and became 15 independent states in the early 1990s, resulting in a move toward market economies.

China operates under a different type of communist government that controls most of the resources and decisions. The economy of China is adopting elements of a market system for a growing number of economic decisions. Entire regions of the country are enjoying a market economy based on greater individual freedom of choice. China is fast becoming a world leader in goods and services produced.

As countries with traditional economies develop, they often adopt mixed economies. The government makes many of the decisions about how the country's resources will be used to develop schools, hospitals, roads, and utilities. As people become educated, they are able to obtain jobs and earn money to purchase more goods and services. Often businesses from other countries will open a business in the developing country and offer jobs and locally produced products to the citizens.



## CHECKPOINT

How does the type of economy affect the way the basic economic questions are answered?

## entrepreneur

famous

**PAUL REVERE** is best remembered as an American patriot who made a famous midnight ride, warning people that the British were coming. However, Paul Revere was also a successful entrepreneur. Trained as a silversmith, he used his engraving skills to create political cartoons to contribute to the movement for independence. He manufactured gunpowder, bullets, and cannons during the Revolutionary War. Afterward, he developed new methods for his trade and founded the Revere Copper Company in 1801. The original company evolved into Revere Copper Products, Inc., which today manufactures a wide variety of products, from industrial equipment to



Photodisc/Getty Images

Why do you think Paul Revere was a successful entrepreneur?

cookware, that bears his name, a sure sign that his business lives on!

### THINK CRITICALLY

Paul Revere was able to use his silversmith skills when starting his business. How important do you think it is to have a skill that you can use when starting a business?

## The U.S. Economic System

What type of economic system do you think the United States has? To answer this question, you must look at who makes most of the decisions about what is produced and consumed. Since individual businesses and consumers make most of these decisions, the U.S. system is best described as a market economy. **Capitalism**, which is the private ownership of resources by individuals rather than by the government, is another name for the economic system in the United States. Another term often associated with the U.S. economy is *free enterprise*, due to the freedom of businesses and individuals to make production and consumption decisions. This individual freedom is vital to the success of the U.S. economy.

The U.S. economic system is based on four basic principles: private property, freedom of choice, profit, and competition.

### Private Property

As a U.S. citizen, you can own, use, or dispose of things of value. You are free to own anything you want, and you can decide what to do with it as long as you operate within the law.

### Freedom of Choice

You can make decisions independently and must accept the consequences of those decisions. Business owners are free to choose where to open a business, what to sell, and how to operate the company. Consumers are free to choose where to shop, what to buy, and how much they want to spend. Only when individual decisions will bring harm to others does the government regulate freedom of choice.

### Profit

The difference between the revenues earned by a business and the costs of operating the business is called **profit**. The opportunity to earn a profit is at the heart of the free-enterprise system. One of the main reasons entrepreneurs invest resources and take risks is to make a profit. No business is guaranteed to make a profit, so entrepreneurs are challenged to work hard, invest wisely, and produce goods and services that consumers are willing to buy.

### Competition

The rivalry among businesses to sell their goods and services is called *competition*. Consumers choose products and services based on the value they think they will receive. Competition forces a business to improve products, keep costs low, provide good customer service, and search for new ideas so that consumers will choose its products or services.



**Describe the four basic principles of the U.S. economic system.**

## did you KNOW ?

According to The International Union for Conservation of Nature, two-thirds of the world's population will face water shortages by 2025.

## Economic Choices

Individuals and businesses are faced with economic choices every day. Decisions about needs and wants must be made. **Economic decision making** is the process of choosing which needs and wants, among several, you will satisfy using the resources you have. Two factors commonly enter into economic decision making—scarcity and opportunity cost.

### Scarcity

In every economy, there are limited resources to produce goods and services. However, individuals have unlimited needs and wants. This produces the basic economic problem of scarcity. **Scarcity** occurs when people's needs and wants are unlimited and the resources to produce the goods and services to meet those needs and wants are limited. For example, land is a scarce resource. Land is used for many purposes, such as for growing crops or as a site for a business or house. The same parcel of land cannot be used to meet all of these needs. A decision on how to use it must be made.

Decisions based on scarcity affect everyone. Individuals and families have many wants and needs. They must decide how to spread their income among all these wants and needs. National, state, and city governments collect taxes from their citizens. They must decide how to use the tax collections to provide all the services that citizens expect. In both cases, someone must make difficult choices.

Scarcity forces you to make choices or decisions. Suppose you earn \$150 a week. If you decide to purchase a \$75 concert ticket and you owe \$75 for your monthly car insurance payment, you will not have any money left over to go out for pizza. Because you have only \$150, you have limited resources. With limited resources, you cannot afford to buy everything you want. You may have to make a *tradeoff* by giving up something so that you can have something else.

### Opportunity Cost

When trying to satisfy your wants and needs, you most likely will have many alternatives from which to choose. Economic decision making will force you to explore all of your alternatives. When examining all of your alternatives, you should consider the opportunity cost of each one. **Opportunity cost** is the value of the next-best alternative—the one you pass up. If your grandparents give you \$300 for graduation, you have to decide what to do with it. If you decide to save the money for college, the opportunity cost would be the new iPod that you really wanted and could have purchased with the money.

Diane Mayfield has \$2,500 in extra cash that she wants to invest in her cake decorating business. Diane could use the money for advertising or she could purchase new equipment. If she decides to use the money for advertising, she will not be able to purchase new equipment. The opportunity cost of advertising will be the value of the new equipment—the next best alternative. Like all entrepreneurs, Diane will have to choose between various investment options.

## CHECKPOINT

What factors affect economic choices?

### Functions of Business

In a market economy, an entrepreneur is free to produce and offer to consumers any legal product or service. Knowledge of business activities will help entrepreneurs satisfy customers and make a profit. These activities or *functions of business* include the following:

- production
- management
- marketing
- finance

Each of these functions is dependent on the others in order for the business to be effective. Products can be produced, but if management is not functioning properly, if adequate financial records are not maintained, or if marketing is not getting the word out to consumers, the products probably will not be sold at a profit.

### Production

The primary reason a business exists in a market economy is to provide products or services to consumers and to earn a profit. The production function creates or obtains products or services for sale.

### Marketing

All businesses in a market economy need to complete marketing activities in order to make their products and services available to consumers. These activities make up the *marketing mix*, which includes the following:

- product
- price
- distribution
- promotion

The goal is to attract as many customers as possible so that the product succeeds in the marketplace.

### Management

It is necessary for all businesses in a market economy to spend a great deal of time developing, implementing, and evaluating plans and activities. Setting goals, determining how goals can be met, and deciding how to respond to the actions of competitors is the role of management. Management also solves problems, oversees the work of employees, and evaluates the activities of the business.

### Finance

One of the first responsibilities of finance is determining the amount of capital needed for the business and how the capital will be obtained.

## BE YOUR OWN BOSS

You are planning to open a sandwich shop. You begin to think about the four functions of business—production, marketing, management, and finance. Describe how each function will apply to your business. Explain how the functions will work together to ensure you run a successful sandwich shop. Be prepared to share your ideas with your classmates.

The finance function also involves planning and managing the financial records of the business.

## CHECKPOINT

What are the functions of business?

## 2.2

## ASSESSMENT

### THINK ABOUT IT

1. Prepare a chart showing how the three basic economic questions are answered by a command, a market, and a traditional economy.
2. Explain how each of the four basic principles of the U.S. economy contributes to the success of our economy.
3. Opportunity cost can affect you personally. Name an item you have wanted to purchase but have not bought because you wanted another item more.
4. Why is it important for all functions of business to work together?

### MAKE ACADEMIC CONNECTIONS

5. **MATH** David Kalb started a pet-walking business in New York City. He charges \$20 to walk one dog twice a day. He walks six dogs five days a week for four customers. He walks three dogs seven days a week for three other customers. How much money does David get from his customers each week? If his expenses each week total \$350, how much profit is he making weekly?
6. **ECONOMICS** Research the economic system of another country. Explain the type of economic system the country has and the effect it has on the lives of the people in the country. Describe how the economic system would affect entrepreneurs in the country.
7. **PROBLEM SOLVING** You worked for your grandmother doing odd jobs around her house. She paid you \$75 for the work you did. You need \$25 to fill your car with gasoline for the upcoming week, \$10 for school lunch, \$40 for prom tickets, and \$30 for a deposit on your tuxedo/dress for the prom. How much money do you still need to cover all your expenses? Since your resources are limited, use the problem-solving model to decide how to spend the \$75. Explain your choices.

### Teamwork



Working in a team, choose a business with which you are familiar. For the business you choose, make a list of the activities that would take place involving each of the four functions of business.

# WHAT AFFECTS PRICE?

## 2.3

### Goals

- Recognize how supply and demand interact to determine price.
- Describe how costs of doing business affect the price of a good or service.
- Explain the effect of different market structures on price.

### Vocabulary

- supply
- demand
- equilibrium price and quantity
- fixed costs
- variable costs
- marginal benefit
- marginal cost
- economies of scale

### Does supply match demand?

"Well, Dad, I went to the mall today to buy my new shoes and nobody had the ones I wanted," Stephanie told her father. "Every store I went to said it had sold out of the shoes because they were on sale. The manufacturer is supposed to send another shipment of the shoes next week." "Oh," her father said, "so more people want the shoes because the price is lower. And the manufacturer is willing to make more shoes even at the lower price because it is still making a profit. This is the law of supply and demand at work."



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**Work as a Team** In the U.S. economy, you have many choices, but sometimes you might not be able to find exactly what you want. Think of products that you have wanted to buy but could not find. Why do you think you could not find them?

Manufacturers must try to keep up with product demand.

## How Much Is Enough?

If a market economy is based on personal choice, why does there always seem to be just enough of everything? In a market economy, individual consumers make decisions about what to buy, and businesses make decisions about what to produce. Consumers are motivated to buy goods and services that they need or want. Business owners are driven by the desire to earn profits. These two groups, consumers and producers, together determine the quantities and prices of goods and services produced.

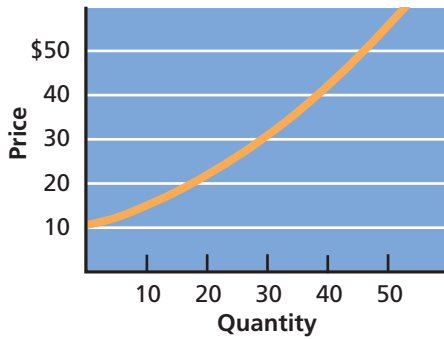
## Supply and Demand

To understand how this works, you need to understand two important forces: supply and demand. **Supply** is the quantity of a good

## focus on Economics

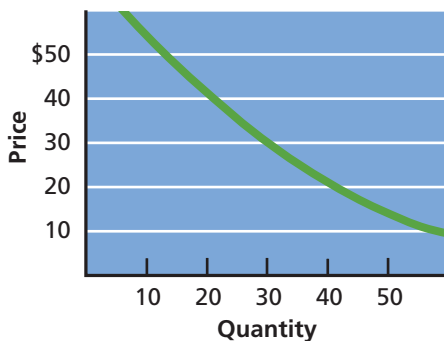


### Supply Curve



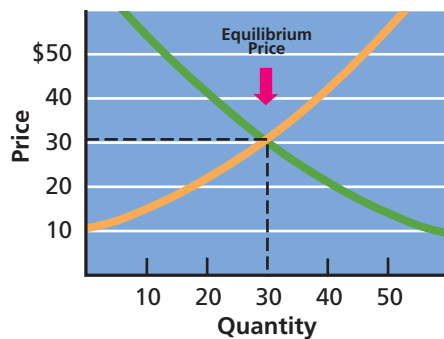
Suppliers are willing to supply more of a product or service at a higher price.

### Demand Curve



Individuals are willing to consume more of a product or service at a lower price.

### Supply and Demand Curves



The point at which the supply and demand curves intersect indicates the equilibrium price and quantity. The equilibrium price is \$30 a unit, and 30 units will be produced.

or service a producer is willing to produce at different prices. Imagine that you supply car detailing services. Suppose that at a rate of \$40, you are willing to spend eight hours a week providing car detailing services. If your customers are willing to pay just \$20 for a car detail, you might decide not to bother detailing cars at all. If, however, the rate for car detailing rose to \$60, you would probably increase the number of cars you would detail. You might even try to get some friends to help you detail even more cars.

As the price of car detailing services rises, suppliers are willing to provide more services. The quantity of car detailing services supplied rises as the price for car detailing services increases, as shown on the supply curve graph.

Now consider the demand side of the market economy.

**Demand** is the quantity of a good or service that consumers are willing to buy at a given price. Suppose that you are interested in having your car detailed. At a rate of \$40, you figure it is worth having your car detailed once a month. If, however, the rate fell to just \$20, you might be willing to have your car detailed twice a month.

As the price of the service or product decreases, consumers are willing to purchase more of the product or service. Demand rises as the price falls, as shown on the demand curve graph.

When the demand for a product is affected by its price, this is referred to as *demand elasticity*. When a change in price creates a change in demand, you have *elastic demand*. When a change in price creates very little change in demand, you have *inelastic demand*. Demand is usually inelastic when

- There are no acceptable substitutes for a product that consumers need
- The change in price is small in relation to the income of the consumer, so consumers will continue to buy the product if they want it
- The product is a basic need for consumers, rather than just a want

## When Supply and Demand Meet

How do the forces of supply and demand work together to determine price in a market economy? The point at which the supply and demand curves meet is known as the **equilibrium price and quantity**. This is the price at which supply equals demand. Above the equilibrium price, fewer people are interested in buying goods and services because they are priced too high. Below the equilibrium price, consumers are willing to purchase more of the goods or services at the lower prices, but suppliers are not willing to produce enough to meet their demand. Only at the equilibrium price does the amount that consumers want to buy exactly equal the amount producers want to supply.

## CHECKPOINT

What effect do supply and demand have on price?

### Costs of Doing Business

To determine how much profit they are earning, entrepreneurs need to know how much it costs to produce their goods or services. To do so, they must consider all the resources that go into producing the good or service to determine a price to charge. Resources may include office space, materials, labor, and equipment. A company that prices its product based only on the cost of materials involved in producing it will lose money and go out of business very quickly.

### Fixed and Variable Costs

Every business has fixed costs and variable costs. **Fixed costs** are costs that must be paid regardless of how much of a good or service is produced. Fixed costs are also called sunk costs. **Variable costs** are costs that go up and down depending on the quantity of the good or service produced.

The Bread and Bagel Shop is a small business owned by Michael Miller. Whether or not Michael makes any sales, he must pay the same monthly rent, the same insurance fees, and the same interest on the loans taken out to finance his business. These are Michael's fixed costs. The store also has variable costs, including the expense of buying flour, sugar, and coffee. These expenses rise directly with the number of items sold. The more bagels, donuts, and cups of coffee the company sells, the more resources it must buy to make more goods. In contrast, when customers purchase fewer loaves of bread, Michael uses less flour and other ingredients.

Understanding the difference between fixed and variable costs is important. A business with many fixed costs is a higher risk than a business with mostly variable costs because fixed costs will be incurred regardless of the level of sales. If sales are lower than expected, the business will have less revenue to pay the bills.

### Marginal Benefit and Marginal Cost

Entrepreneurs make business decisions based on the concepts of marginal benefit and marginal cost. **Marginal benefit** measures the advantages of producing one additional unit of a good or service. **Marginal cost** measures the disadvantages of producing one additional unit of a good or service.

Michael Miller of The Bread and Bagel Shop wants to increase his sales. Michael is considering keeping the store open two extra hours every day. He estimates that during the last two hours of every day, he will sell an additional 50 baked goods and 20 cups of coffee, bringing in additional daily revenues of \$100. This \$100 represents the marginal benefit of keeping the store open an extra two hours a day.

To determine if staying open later makes economic sense, Michael needs to calculate the marginal cost of staying open later. He will need to purchase additional ingredients to produce another 50 baked goods and 20 cups of coffee. He will have to pay overtime wages to at least two employees. He will also use more electricity. After adding up these costs, Michael estimates that staying open two extra hours will cost him \$125 per day. Because the marginal cost of staying open (\$125) exceeds the marginal benefit (\$100), Michael decides not to change the store's hours.

## Economies of Scale

When a business owner decides to grow the business, he or she needs to consider the **economies of scale**, which are the cost advantages obtained due to expansion. Businesses can expand their scale of operations in many ways, such as expanding the size of their facility, obtaining specialized machinery, and using a greater specialization of labor. Economies of scale represent an increase in efficiency of production as the number of units of goods produced increases. A business that achieves economies of scale lowers the average cost per unit through increased production because costs can be spread over an increased number of units. Lower costs per unit allow businesses to lower the prices of their product or service, which may attract more customers.

# what went wrong?

## AVOID PERSONAL DEBT

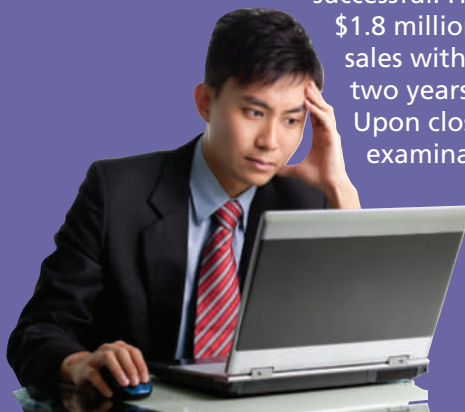
Dave McClure took on a great amount of debt when he founded a Web and database services company, Aslan Computing. He used his own personal savings and took out a second mortgage on his home to get the money he needed to get his business off the ground. At first, it appeared that Dave's venture was successful. He made \$1.8 million in sales within two years. Upon closer examination

of his financial records, however, things did not look as good. Although Dave's business generated a large amount of revenue, it did not generate much profit. Aslan Computing's costs exceeded its revenues, and it incurred a net loss of \$50,000 the second year. On the brink of collapse, no bank would lend Dave additional funds. He managed to sell the business for enough money to pay off his debts.

### THINK CRITICALLY

1. Do you think it is wise for a business owner to take on a large amount of personal debt when starting a business?
2. What other options does an entrepreneur have if no bank is willing to loan money to help finance the business?

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When starting your business, be sure to avoid personal debt.

## CHECKPOINT

How do the costs of doing business affect prices?

### Market Structure and Prices

Market structure is determined by the nature and degree of competition among businesses that operate in the same industry. The main criteria used to distinguish between different market structures are the number and size of sellers and buyers in the market, the type of goods and services being traded, and the barriers to entry into the market for sellers. There are four major market structures: perfect competition, monopolistic competition, oligopoly, and monopoly.

#### Perfect Competition

A market with *perfect competition* consists of a very large number of businesses producing nearly identical products and has many buyers. Buyers are well-informed about the price, quality, and availability of products. Because consumers have so many choices of similar products, price is often the deciding factor, making it difficult for a single business to raise prices. This gives consumers more control of the market. Businesses can easily enter or leave this type of market. Examples of industries in perfect competition include gasoline suppliers and producers of agricultural products such as wheat and corn.

#### Monopolistic Competition

A market with *monopolistic competition* has a large number of independent businesses that produce goods and services that are somewhat different. Each business has a very small portion of the market share. This is also called a competitive market. In a competitive market, many suppliers compete for business, and buyers shop around for the best deal they can find. In this kind of market, prices are said to be determined competitively. Products offered are not identical but very similar, so differentiating products is important. Businesses can easily enter or leave a market that has monopolistic competition. Businesses in this market include retail stores and restaurants.

#### Oligopoly

When a market is dominated by a small number of businesses that gain the majority of total sales revenue, it is called an *oligopoly*. Businesses in this market sell similar goods and services that are close substitutes, and they have influence over the price charged. With the dominance of a few businesses, it is not easy for new ones to enter the industry. Examples include the automobile and airline industries.



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What kind of competition do you think a TV manufacturer faces? Why?

## Monopoly

Where there is only one provider of a product or service, a monopoly exists. A company that has a *monopoly* is able to charge whatever price it wants because consumers have nowhere else to go to find a better price. This is the opposite of a competitive market where consumers can simply switch to a lower-priced good or service offered by a competitor. Monopolies usually exist because of barriers that make it difficult for new businesses to enter the market. Examples include local water and electric utility companies.

### CHECKPOINT

How does the market structure affect the price of a good or service?

## 2.3

## ASSESSMENT

### THINK ABOUT IT

1. Have you ever wanted to buy something, but you couldn't find it? What role do you think supply and demand might have played?
2. Name three fixed costs in your life. How do you plan to pay them? Name three variable costs that you have. How can variable costs be like opportunity costs?
3. Think of an item you purchase often. If the price is similar at several stores, do you always buy at the same store? Why or why not?
4. Describe the important features of each of the market structures.

### MAKE ACADEMIC CONNECTIONS

5. **MARKETING** Find advertisements for two competing products. Analyze the ads to see how the products are differentiated. Make a poster of the two ads and label the items that are different.
6. **ECONOMICS** Create a table with two columns. In the first column, list the four market structures. In the second column, list 5 to 10 goods or services that would be available in each of the different market structures.

### Teamwork



Working in a team, brainstorm a list of businesses in your state and your local area. Discuss with your teammates the type of market structure in which you think each business operates. Give reasons for your choices. Share your list with your classmates.



# Sharpen Your **21st CENTURY** ENTREPRENEURIAL SKILLS

## **Effective Presentation Skills**

Much of your communication as a business owner will be conducted verbally. You may have to make a presentation to sell your business idea to potential investors, or you may have to make a presentation to convince potential customers to purchase your product or service. How you present yourself will have a big impact on the people with whom you deal.

When preparing a presentation, you should be concise, but give adequate information to cover the topic being presented. An effective presentation has three parts.

- 1. Introduction** You should begin your presentation with an attention-getting opener that introduces your topic. Asking a question or using a famous quote is a good way to get your audience focused on the topic.
- 2. Body of Presentation** Try to limit your presentation to three main points. It is often helpful to provide a visual aid that lists your key points. Do not overwhelm your audience with too much detail. Use facts and other supporting information to reinforce your main points. Keep the presentation simple and avoid using complicated language.

- 3. Conclusion** After presenting your main points, summarize what you have told your audience in a brief conclusion.

### **Try It Out**

To practice your presentation skills, research an entrepreneur who you believe has been a change agent. Prepare an effective presentation for the class explaining the impact this entrepreneur has had on other people's lives.

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## SUMMARY

**2.1 Entrepreneurs Satisfy Needs and Wants**

1. Economics is about making choices and satisfying the needs and wants of consumers. Needs are things you must have to survive. Wants are things you think you must have to be satisfied.
2. Three kinds of economic resources are used by entrepreneurs to produce goods and services—natural resources, human resources, and capital resources.
3. Entrepreneurs play an important role in the U.S. economy. They supply goods and services, provide capital investment and job creation, and serve as agents for change.

**2.2 How Economic Decisions Are Made**

4. In a command economy, the government determines what, how, and for whom products and services are produced. In a market economy, individuals decide what, how, and for whom products and services are produced. A mixed economy combines elements of the command and market economies. Traditional economies are simple economies operated according to tradition or custom.
5. The U.S. economic system is based on the principles of private property, freedom of choice, profit, and competition.
6. Economic choices are necessary because of our unlimited desires and the scarcity of resources available to satisfy them. Every economic decision incurs an opportunity cost.
7. The functions of business are production, marketing, management, and finance. Each function is dependent on the others.

**2.3 What Affects Price?**

8. Supply is the quantity of a good or service a producer is willing to produce at different prices. Demand is the quantity of a good or service that consumers are willing to buy at a given price.
9. Fixed costs remain the same regardless of how much of a good or service is produced while variable costs go up and down depending on the level of production.
10. Market structure is determined by the nature and degree of competition among businesses that operate in the same industry. The four major market structures are perfect competition, monopolistic competition, oligopoly, and monopoly.

What  
do you  
know  
now?

Read *Ideas in Action* on page 37 again. Then answer the questions a second time. Have your responses changed? If so, how have they changed?

## VOCABULARY BUILDER

Match each statement with the term that best defines it. Some terms may not be used.

1. Things that you think you must have in order to be satisfied
2. The means through which goods and services are produced
3. Occurs when people's needs and wants are unlimited and resources are limited
4. The process of choosing which wants you will satisfy using the resources you have
5. The value of the next-best alternative—the one you must pass up
6. The point at which supply and demand meet
7. Measures the advantages of producing one additional unit of a good or service
8. Private ownership of resources by individuals
9. The quantity of a good or service consumers will buy at a given price
10. Costs that go up and down depending on the quantity of the good or service produced

- a. capitalism
- b. demand
- c. economic decision making
- d. economic resources
- e. economies of scale
- f. equilibrium price and quantity
- g. fixed costs
- h. marginal benefit
- i. marginal cost
- j. needs
- k. opportunity cost
- l. profit
- m. scarcity
- n. supply
- o. variable costs
- p. wants

## REVIEW YOUR KNOWLEDGE

11. An example of a noneconomic want is
  - a. clothing
  - b. housing
  - c. friendship
  - d. cars
12. Which of the following is *not* an example of a service?
  - a. lawn care
  - b. car wash
  - c. bicycle
  - d. cable TV installation
13. If a product has inelastic demand, a price increase will cause
  - a. consumers to buy more
  - b. competitors to enter the market
  - c. consumers to buy less
  - d. little or no change in the demand for the item
14. What are the three basic economic questions countries must answer?
15. What determines the type of economic system a country has?
  - a. the political beliefs of the country's ruler
  - b. the way the basic economic questions are answered
  - c. the resources of the country
  - d. the demands of the people
16. Which of the following is *not* a role of entrepreneurs in the U.S. economy?
  - a. supply goods and services to meet consumer needs and wants
  - b. provide capital investment and job creation
  - c. determine how to allocate natural resources
  - d. serve as agents for change
17. Another name for economic resources is
  - a. factors of production
  - b. goods and services
  - c. supply and demand
  - d. command economy



18. The four basic principles of the U.S. economic system are
  - a. private property, freedom of choice, loss, competition
  - b. taxed property, freedom of choice, profit, competition
  - c. private property, freedom of choice, profit, competition
  - d. private property, limited choice, profit, competition
19. Which of the following is *not* a function of business?
  - a. production
  - b. marketing
  - c. job creation
  - d. finance
20. If you were going to start a small cake decorating business, which type of market structure would you most likely be entering?
  - a. perfect competition
  - b. monopolistic competition
  - c. oligopoly
  - d. monopoly
21. The Ford Motor Company operates in which type of market structure?
  - a. perfect competition
  - b. monopolistic competition
  - c. oligopoly
  - d. monopoly

### APPLY WHAT YOU LEARNED

22. You plan to start a grocery delivery service. Analyze the possible demand for such a service by brainstorming answers to the following questions: Who is likely to use this service? Besides delivering groceries, what other services could such a business offer? What other questions should you consider?
23. Susan Tran of Nails by Susan wants to increase her sales. Susan considers keeping the nail salon open two extra hours every day. She estimates that during the last two hours of every day, she and her staff could provide nail services to five more customers, bringing in additional revenues averaging \$125 a night. Susan estimates that providing the services to five more customers each night would cost approximately \$25 in supplies. Her operating expenses for electricity and water will increase by approximately \$20 per night. She would also have to pay two employees to work the extra two hours at a cost of \$30 each. What is the marginal benefit of staying open an extra two hours a day? What is the marginal cost? Do you think Nails by Susan should stay open two extra hours each day?

### MAKE ACADEMIC CONNECTIONS



24. **MATH** You have a business baking and selling chocolate chip cookies. Access [www.cengage.com/school/entrepreneurship/ideas](http://www.cengage.com/school/entrepreneurship/ideas). Click on *Activities* and open the file *Business Costs*. Print a copy and complete the activity. What are the costs of doing business? Are these fixed costs or variable costs?

25. **COMMUNICATION** Marketing plays an important role as one of the functions of business. Research and write a report explaining how each of the other functions—production, management, and finance—depends on the marketing function. Present your report to the class.
26. **ECONOMICS** Identify and research economies in the process of converting from a command to a market economy. What events led to this change? What involvement, if any, do U.S. companies have in these countries' economies? Discuss your findings with the class.

## What Would YOU Do?

You and a partner own a home security business, which sells a variety of home security devices, such as surveillance systems, alarms, and motion detector lighting systems, among others. A senior citizen comes to your store to get some information about the types of security systems your company offers. Your partner asks the elderly customer for some basic information, such as where she lives. Using this information, your partner tries to falsely convince the customer that she lives in a crime-ridden neighborhood and, thus, needs

several different security devices to ensure her safety. The customer is ready to sign a contract for the purchase of a very expensive home security package. Suddenly, your partner is called away to take a phone call and asks you to finish helping the customer. You overheard the entire discussion between your partner and the customer, and you don't believe she needs such an extensive home security system. Business is slow due to a downturn in the economy, and you need all the sales you can get. What will you do?

## build your BUSINESS PLAN PROJECT

Based on the business idea you identified in Chapter 1, complete the following activities.

1. Access [www.cengage.com/school/entrepreneurship/ideas](http://www.cengage.com/school/entrepreneurship/ideas). Click on *Activities* and open the file *Supply and Demand*. Print a copy and complete the activity for at least one good or service your business will provide. Then use the graph to determine the price to charge for that good or service.
2. Determine the fixed and variable costs for your business. Estimate how much money you will need to cover these costs. Make a chart showing these expenses. Do you need to adjust your pricing for your business to make a profit?
3. Consider adding another product or service to your business. What are the marginal costs and benefits of adding this new product or service? Is it a good or bad idea to add the item?



# Planning a Career in

## PROPERTY MANAGEMENT



“Our softball coach threw an end-of-season party for team members and their families at the pool in his neighborhood. A pool, playground, tennis courts, and clubhouse are shared and maintained by the community. He said that although the community elected a board of residents to plan for the community, the day-to-day maintenance of the community was handled by a property management company.”

Who changes the light bulbs in the common areas of private communities? How is the landscaping of common areas managed in private communities? Who takes care of routine maintenance at retail sites?

Property management companies assist a variety of businesses by managing their daily operations. Retail locations, office parks, and residential communities use their services.

### Employment Outlook

- Average job growth is expected.
- Almost half of property managers are self-employed.
- As new home developments form neighborhood associations to manage common areas, the need for property managers should increase.

### Job Titles

- Assistant Facility Manager
- Commercial Property Assistant
- Occupancy Specialist
- Homeowners Association Field Manager
- Community Association Manager
- Portfolio Manager—Property Management

### Needed Education/Skills

- A Bachelor’s degree is recommended.
- Strong financial, problem-solving, and multitasking skills are required.
- A background in real estate or facilities management is helpful.

*What’s it like to work in Property Management?* Ari, the owner of a property management company, is posting the minutes of a neighborhood’s annual meeting on the neighborhood’s website. Website maintenance is just one of the many services provided by Ari’s company.

Ari’s next task is to analyze landscaping bids for a condominium community he is managing. He will prepare a report on the three most competitive bids and present them to the condominium’s board at the monthly meeting. In addition to providing a financial summary of the bids, Ari will also provide information regarding the reliability of the various landscaping companies. Because he manages several communities, Ari is able to obtain feedback on the effectiveness of a variety of landscaping companies.

After lunch, Ari reviews the time cards for the lifeguards at a neighborhood community pool. Because the neighborhood lacks the resources to manage employees, it pays Ari’s firm to handle the contract for the community’s lifeguards.

*What about you?* Would you like to manage the daily operations of communities to help them run smoothly?

# Emerging Business Issues Event



The Emerging Business Issues Event provides FBLA members with an opportunity to develop and demonstrate skills in researching and presenting an emerging business issue. The event is based on team rather than individual participation. In addition to learning research skills, team participants develop speaking ability and poise through oral presentations.

Each year a national topic is selected by FBLA-PBL Inc. You can find the current topic on the FBLA website. Teams must research the topic and present an affirmative or negative argument, based upon random selection. Facts and working data should be secured from reliable sources.

## Performance Competencies

- An understanding of the topic must be evident
- The topic should be presented in a logical manner
- All team members must contribute to the presentation
- Arguments should be persuasive and relevant to the topic
- Questions must be answered effectively

*Go to the FBLA website for more detailed information.*

### GIVE IT A TRY

Using the current national topic for the Emerging Business Issues event, complete the following activities:

- Working with team members, research the topic and prepare to present either an affirmative or negative argument.
- Draw to determine whether you will present an affirmative or negative argument.
- Finalize your preparations in five minutes.
- You may use prepared notes during the preparation and presentation. In addition, each team member will be given two blank note cards for recording notes that can be used during the preparation and performance of the presentation. Information may be written on both sides of the note cards.
- No reference materials, visual aids, or electronic devices may be brought to or used during the preparation or presentation.
- Make the presentation to your class. The presentation should last no longer than five minutes.
- Be prepared to answer questions after your presentation.

[www.fbلا-pbl.org](http://www.fbلا-pbl.org)