Part 1

Basic Concepts in Business

Unit 1 Business and Business Regulations

I Function, Environment, and Social Responsibility of Business

1 Functions of Business

Business is originally an organized process or approach used by individuals to make profit by providing goods and services to other individuals. From modern economic view, this process, in turn, helps raise a nation's standard of living, primarily because it leads to increased production.

Standard of living is a term we use when we talk about how well off the people of a particular nation are. Often it is measured by dividing total production by population. The reasoning behind this method of calculation is simply that if production is high and/or population is low, there are more goods and services available to everyone. Today the nations of the world can be divided into two broad categories: those that have a high rate of productivity and those that have a low rate, in relation to their populations. As a result, there are "have" and "have-not" nations. The U.S. is one of "have" nations because when its production is divided by its population, it ends up with a lot of "good things in life." While the standard of living in China has not reached the level of the "have" nations yet, because its population is several times larger yet its production is less than that of the U.S. Of course, business can do very little to directly increase or decrease a country's population. However, they can work to increase the production of goods and services, for example, by making available to consumers more air conditioners, refrigerators, and television sets at prices low enough for people to afford. As this happens, the overall standard of living increases.

Why do some countries have low standards of living while others have high ones? One answer is found in the factors of production a country possesses and what it does with them. In all, there are four factors of production: land, labor, capital, and technology.

Land refers to both geographic territory and natural resources. Labor refers to the people who produce the goods and services. Capital refers to the money and physical labor-saving devices that help people do their work better and faster. Technology refers to the application of knowledge to production.

The success of a country's economy and the living standard level of its people depend largely on how it is able to use these factors of production wisely.

2 Business Environment

All businesses are operating in a certain environment. This environment is made up of many smaller environments.

There is the historical environment. By studying what has already happened, business can be in a better position to forecast and prepare for the future, anticipate new developments and plan for them. For example, American business development experienced the following three stages:

- Private ownership free from government control, i.e. laissez-faire capitalism;
- Machines replacing men, i.e. industrialization;
- Government legislation to regulate business, i.e. modified capitalism.

While Chinese business in the past thirty or more years has transformed from government planning to market adjusting.

There is the natural-physical environment, which consists of all our physical resources. All our resources, including air, water, iron ore, oil, silver, and copper, etc., are depleting and irreplaceable. Therefore, these resources must be used wisely.

There is the political-legal environment, which mainly consists of the laws the government has enacted over the past hundred years to regulate business. It is also made up of the relationship that exists between business and government. Laws and regulations restrict business activities, and political happenings influence business, for instance, the impact of government purchase on suppliers, competitors, and customers.

There is the social-cultural environment, which is made up of the beliefs, attitudes, and customs of everyone in the society. Though over the past hundred years these have changed dramatically and resulted in completely new challenges to business, business has to coordinate its objectives with the values and beliefs of the society in which it runs.

Finally and most importantly, there is the economic environment, which consists of customers and competitors. Moreover, it is an environment related with the factors of buyers, sellers and competitors, in which business sells products and services to customers. This environment is of more concern to business than any other. For this reason, managers need a working knowledge of economics.

Economics is the allocation of scarce resources for the purpose of fulfilling the society's needs. For every business firm the greatest concern is how economic conditions will affect it directly. This interest can only be satisfied through an analysis of the overall economy as well as a review of the specific situation within the particular industry or market where the firm does business.

The most common indicator in judging the overall economy is GNP (Gross National Product). GNP is the total value of all goods and services produced in an economy in one year. In arriving at this total value, it is common to use an expenditures-equal-income approach. All money spent on goods and services must have been received by others as income. Since this GNP equation is made up of a number of different parts, it is possible to analyze and sometimes predict the overall economy on the basis of what is happening in each part. Yet these estimates can be wrong, for the economy tends to run in cycles. During the current decade, for example, we have had quite a time with stagnant economic growth and inflation, known as stagflation. This is a big change from the solid economic growth we have witnessed in the past thirty years.

While business is concerned with the overall economy, it is more interested in what is happening internally. This knowledge requires an analysis of consumer demand, production costs, and pricing. It calls for an understanding of specific industry conditions and competitiveness. In all, there are four basic types of industry market models: pure monopoly, oligopoly, monopolistic competition, and pure competition, each having its own characteristics.

Therefore, business environment refers to those social factors that surround and affect business operation and to which businesses have to adjust. For example, government laws, bills or actions; price changes; new products; workers' requirements for better wages, and so on.

3 Social Responsibility of Business

Social responsibility is the obligation business has to assume for the welfare of the society in which it operates. This responsibility extends to a number of important groups, including owners, customers, creditors, employees, the government, and the community. At the present time the social responsibility of business can be categorized into three main areas: equal opportunity, ecology, and consumerism.

Why is business involved in this social responsibility area? There are several reasons, which relate to changing personal values, enlightened self-interest, managerial know-how, and government legislation. Each of these is a sufficient reason alone, but together they create a great willingness on the part of business to do its part in helping the society. As a result, there are many business programs today for providing equal opportunity, including minority hiring programs, support for minority capitalism, and the hiring, training, and promoting of female employees. There are also programs for protecting the environment by fighting air, water, and noise pollution. Finally, there are programs to ensure consumer protection by providing information and product safety. The development of these programs illustrates that business is not only aware of its social responsibility but also meets the challenge with positive action.

Business has to undertake moral obligation for the welfare of the society in which it survives. While social responsibilities of different businesses may differ, traditionally most businesses are mainly obligated to the following six subjects (See Figure 1-1).

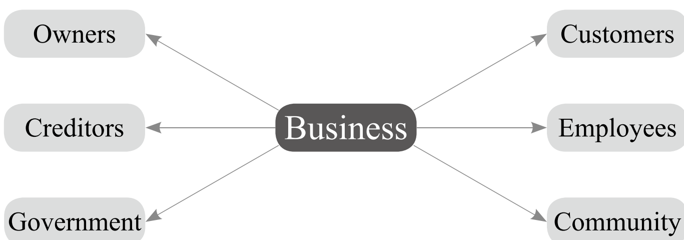

Figure 1-1 Six Main Business Obligation Subjects

II Business Forms

When an individual decides to go into business for himself or herself, an evaluation must be made of the various possible forms of ownership. These forms are generally categorized into three types: sole proprietorship, partnership, and corporation.

1 Sole Proprietorship

Sole proprietorship, owned and controlled by one individual, is the easiest form of ownership to start or to dissolve. Some of its common advantages include the fact that the owner gets to keep all the profits, has the freedom of deciding what he or she wants to do, can keep the operations very secretive, and often derives a good deal of personal satisfaction from business successes. However, the downside is that sole proprietors must assume unlimited liability for all obligations. Other disadvantages are that the size to which proprietorships can grow and the life of the business are both limited. The advantages and disadvantages of sole proprietorship can be summed up as follows:

Advantages:

- Less financial burden: no profit sharing/low tax/higher credit standing, etc.;
- Less restrictions in management: quick decision-making/easy to set up and manage/more free time, etc.;
- More privacy and secrecy in: sales/profit margins/production process/financial status, etc.;
- More personal satisfaction: operating in one's own way/being one's own boss, etc.

Disadvantages:

- Unlimited liability: risking all the proprietor's personal possessions for debts owners/creditors;
- Limited size: limited in financial sources/limited managerial skills/with few to share workloads and ideas, etc.;
- Limited life: life span of the owner/potential bankruptcy.

2 Partnership

A partnership consists of two or more people as co-owners who get together to operate a business for profit. The most common type of partner is the general partner, who has unlimited liabilities. However, there are other types as well, including limited partner, silent partner, secret partner, dormant partner, and the nominal partner.

Descriptions of responsibility for each kind of partner are as follows:

• General partner: unlimited liability (risk all his or their assets); playing an active role in the firm's operation; assuming ultimate responsibility for all the firm's obligations; empowered with the right of entering into contracts in the name of the business. There is at least one general partner in such a business.

• Limited partner: limited liability (only risk his own or the partner's investment); playing no active role in the operation of the business; having no right to enter into contracts.

• Silent partner: known by the public as an owner of the business but playing no active role in managing the operation; having no voice in operational matters.

• Secret partner: playing an active role in running the business, but not known as a partner by the general public.

• Dormant partner: playing no active role in running the firm, and not known as a partner by the general public.

• Nominal partner: lending name to the enterprise but investing no money in the business and playing no role in business administration.

In contrast to the sole proprietorship, the partnership form of ownership offers the partners a better chance to raise capital and credit and to improve their decision-making by having two or more people thinking through business problems. In addition, there is the possibility for expansion and growth with few problems about the legal status of the partners, because these issues have now virtually all been resolved by the courts. On the other hand, all the partners except those with limited liability must assume responsibility for all obligations of the firm. Also, there are problems with continuity, management of the partnership, and size of the organization. The advantages and disadvantages of partnership can be summed as follows:

Advantages:

- Increased sources of capital and credit: numerous capital resources/ less risk for creditors;
- Improved decision-making potential;
- Possibilities for expansion and growth;
- Definite legal status.

Disadvantages:

- Unlimited liability;
- The problem of continuity and risk of dissolving (if any of the partners withdraws, dies, goes to jail, the business is most likely to terminate);
- Managerial problems: "too many cooks spoil the broth";
- Size limitations: limited capital and credit from bankers.

3 Corporation

Major business firms today are not sole proprietorships or partnerships; they are corporations, an artificial being that has the right to conduct business affairs in its own name, a legal person (as a natural person under the law) who can treat (receive, own, and transfer) property, sign contracts, sue and be sued in court. Perhaps the reason why so many large firms choose to incorporate is the advantages offered by this form of ownership. One positive factor is that all stockholders have limited liability. Second, a corporation can exist indefinitely. Third, it has greater growth potential and managerial efficiency than do most proprietorships or partnerships. Finally, if any stockholders are dissatisfied with the way the company is performing, they can usually sell their stocks and withdraw from the ownership.

Of course, these advantages must be compared with the disadvantages. Not only is the corporation subject to heavy taxation, it also has high organizing expenses. In addition, there are government restrictions on operations, and also a lack of secrecy that permits competitors at least some information about what the company is doing. The advantages and disadvantages of corporation can be summed up as follows:

Advantages:

- Limited liability: corporation as a legal entity does need the stockholders to be responsible for its debts;
- Indefinite life: not influenced by the death of the owner;
- Growth potential: more capital by selling bonds and shares;
- Managerial efficiency: division of responsibility allows the company to hire professionals to run the business;
- Transfer of ownership: by stock exchange.

Disadvantages:

- Heavy taxation: double taxation compared with that of the other two forms of ownership;
- Expenses: high organizing expenses;
- Government restriction: regulated in sale of stocks/required to be examined by government agencies;
- Lack of secrecy: limited secret operations, annual report containing financial data provided to the public;

The advantages and disadvantages of the three different business forms mentioned above are summed up below in Table 1-1.