

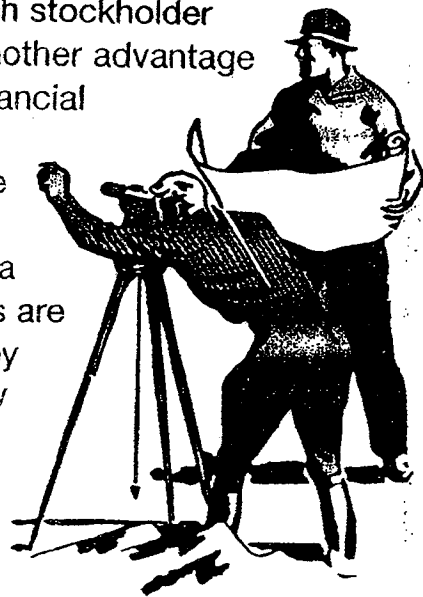
Making the Market Economy Work: Business and the Entrepreneur

In a command economy, government determines and directs economic activity. However, in a market (capitalist) economy, economic decisions are made primarily by millions of independent consumers and businesses responding to prices. Businesses attempt to satisfy the wants of consumers in order to earn **profits**. Those who successfully satisfy consumer wants will prosper; those who do not will suffer losses and fail.

Types of Business Ownership: There are three types of business ownership. A **sole proprietorship** has only one owner. This owner has complete control of the business and reaps all profits and suffers all losses. While it is relatively easy to start a sole proprietorship, a major consideration is that the owner is fully and personally liable for all business debts and actions. It also can be difficult for one individual to raise the **financial capital** (money) necessary to operate the business.

A **partnership** is a business that has two or more owners. It is easier to expand this type of business since the partners usually can raise a larger pool of financial capital. There is also shared risk, so if the business fails, all partners share any losses. Partners also bring additional management skills to the business. But there are disadvantages to a partnership. Obviously, the profits must be shared. Also, liability is still unlimited, so partners are personally liable for all business actions and debts. A major problem is that the partners frequently have difficulty agreeing on decisions. Dissolving a partnership can also be difficult.

A **corporation** is a company chartered by the state and owned by stockholders. The stockholders are represented by a board of directors and are liable for company actions and debts only up to the amount each stockholder has invested. This feature is called **limited liability**. Another advantage of the corporation is that it is relatively easy to raise financial capital. Transferring ownership is also easy since it frequently means only selling stock. Disadvantages are that corporations are subject to special government regulations, and that individual stockholders may have a rather limited say in company operations. Corporations are also taxed significantly since profits are taxed when they are earned (via the **corporate profit tax**) and when they are distributed to stockholders as **dividends**.



Three Types of Business Ownership

1. Sole Proprietorship
2. Partnership
3. Corporation

How Businesses Raise Financial Capital: There are three basic ways that businesses raise **financial capital** to start or expand business operations: savings, loans, and stock issues. **Savings** can be personal savings or can be business savings taken from previous profits. Using savings gives the business complete control over how the funds are spent, and, of course, there is no debt to repay. A disadvantage is that it frequently takes a long time to save sufficient funds.

Loans represent debt and must be repaid with interest. Businesses borrow money in a variety of ways, usually from banks or other lending institutions. Businesses also issue debt instruments called **bonds** to borrow money. Borrowing money instead of waiting to accrue savings allows business projects to start much sooner. Issuing **stock** is the third way to raise financial capital. The company issues **stock certificates**, which represent shares in the company. Each share is issued at an initial market price, but the future price of the shares fluctuates depending on the success of the company. Stocks represent ownership (equity) in the business, and stockholders have voting rights proportional to the amount of stock owned. Stockholders elect a board of directors to oversee business operations and make major decisions. Since stocks are not debt, the stockholders bear the risk of the success or failure of the business. If the business earns profits, stockholders frequently receive **dividends**, which may grow if the business remains successful. An individual wanting to relinquish ownership must sell the shares to another individual. **Stock markets** have evolved to make such transactions easier. The New York Stock Exchange is probably the best known stock market.

Three Ways Businesses Raise Financial Capital

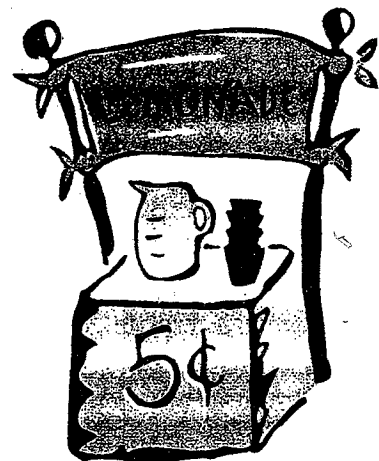
1. Personal or Business Savings
2. Borrowing (loans or bonds)
3. Stock Issues

The Role of the Entrepreneur: The key individuals in a market economy who initiate the production of goods and services to satisfy the wants of consumers are called **entrepreneurs**. Entrepreneurs combine productive resources (natural, human, and capital) to produce goods and services that they expect to sell for a price high enough to cover production costs.⁷ The dollar amount remaining after all production costs have been subtracted is called **profit**.

Since the future is not known, it is not certain that entrepreneurs will earn profits. Many business ventures suffer losses and eventually fail.⁸

Entrepreneurs may overestimate consumer demand for a product, or prices of productive resources may rise unexpectedly. There could be labor strikes, unexpected and costly government regulations, or increased international competition. The uncertainty of the future guarantees that every business venture will entail some degree of **risk**. Entrepreneurs will produce goods and services only if the expected profits are great enough to warrant the risk incurred in production.

In the final analysis, the market (price) system's ability to provide goods and services depends on the effort and ingenuity of individual entrepreneurs. It is they, responding to future and, therefore, uncertain consumer demand, who decide what to produce, how to produce, and for whom to produce. Individual entrepreneurs are the driving force in the market economy's answer to the problem of scarcity.



7. Many economists classify entrepreneurship as the fourth basic productive resource.

8. Only about 50% of small businesses are still operating three years after initial set up.