

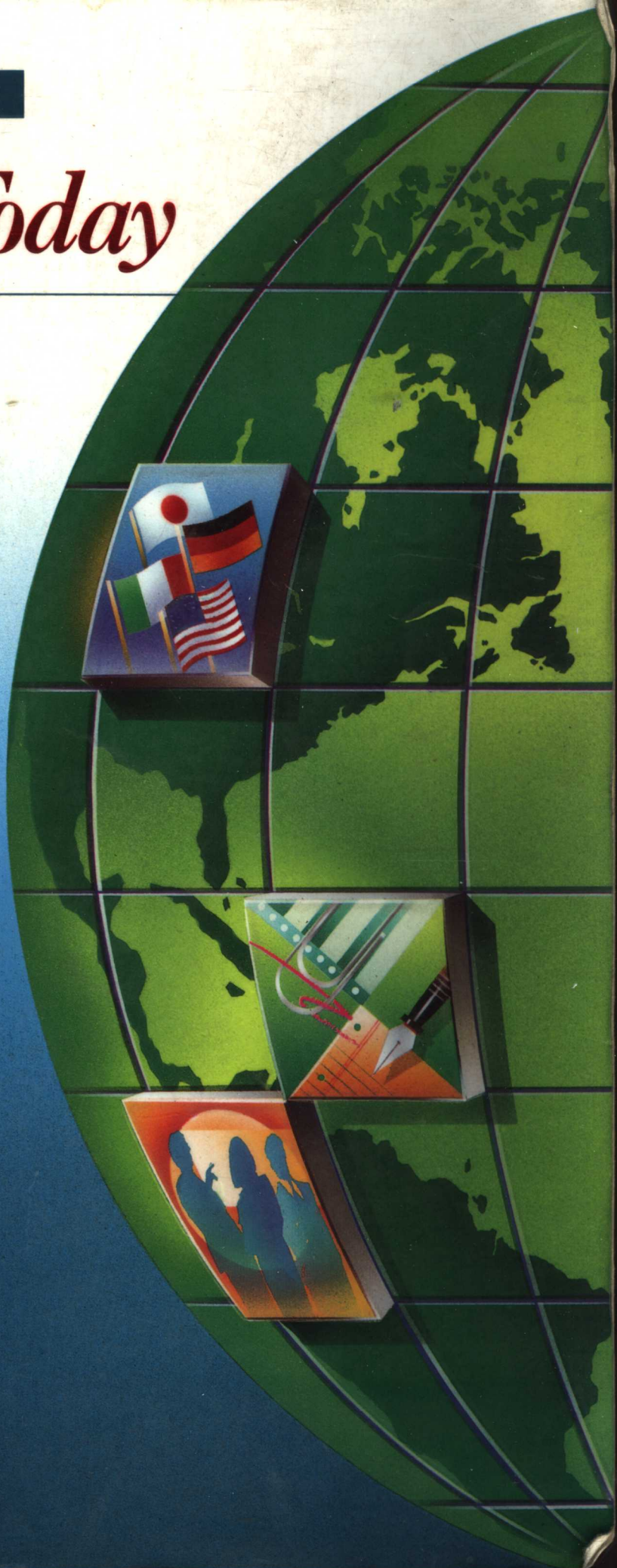
STUDY GUIDE

Business Today

Seventh Edition

David J. Rachman
Michael H. Mescon
Courtland L. Bovée
John V. Thill

STANLEY GARFUNKEL
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STUDY GUIDE BUSINESS TODAY

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Introduction

The aim of the *Study Guide for Business Today, Seventh Edition*, is to enable you to obtain the maximum benefit from the time you spend studying business. You may already have developed efficient and satisfactory study techniques, or you may feel that you need some help in this respect. In either event, since you are not yet familiar with the subject, you will probably find the guidance offered here to be helpful. It will ensure that you will be able to discriminate between crucial and less important information, to check your memory and understanding of new concepts, and to broaden your knowledge of the subject by application.

Following this introduction is a section entitled "Approaching Your Introduction to Business Course—Study Hints and Test Strategies." This material will be of use to all students, for it outlines how to get the most out of a college textbook. Instead of memorizing endless pages, you'll learn to pick out the key points and terms. And if you've ever got a test question wrong, even though you understood the material (perhaps because you overlooked the words *all* or *except*, which gave a different meaning to the statement), you'll appreciate the test strategies material. This section discusses how to interpret test questions and answer them accurately, and discusses the best general approach to taking tests.

The *Study Guide* itself consists of the following items:

1. For each chapter:
 - Learning Objectives
 - Outline
 - Major Points to Remember
 - Key Terms
 - Key Terms Exercise (Answer keys included)
 - Self Test (Answers at the end of the *Study Guide*)
 - Projects
2. At the back of the *Study Guide*:
 - Answers to Self Tests
 - Supplemental Test Questions (Covering all chapters)

The *Learning Objectives* at the beginning of each *Study Guide* chapter are identical to those in the text; they succinctly state what you should know after studying the text chapter. If after reading the text you can do what the objectives ask, you have a good grasp of the material; if you can't, you should review those areas where your knowledge is weak. The *Outline* serves as a "road map" to the text chapter. It helps you to quickly get your bearings on what is covered and how the topics relate to each other. The *Major Points to Remember* expand on the *Outline* and highlight (with explanations) the important points you should know. The *Key Terms Exercise* thoroughly tests your knowledge of basic business terminology. Don't be tempted to look at the answers (inverted, following the exercise) before you complete the tests. The *Self Test* questions are similar to those you'll see in class exams. Take the tests and check your answers against those provided in the *Answers* section at the end of the *Study Guide*. These exercises and tests are designed to help you target your weak areas as well as to give you positive feedback. In the long run, this knowledge will help you use your study time more effectively.

The *Projects* show you how you can apply the concepts you're learning to specific, lifelike, situations, and give you some experience in problem solving and decision making in business. Many of the projects are research-oriented and require you to gather information from various sources. Some direct you to useful reference materials in

your school library; others involve obtaining information directly from businesses in your community. You will find practicing research techniques is good experience for the future. The *Supplemental Test Questions* are similar to the *Self Tests* but appear without answers. Your instructor may choose to use these questions for quizzes or may make the answers available to you so you can test yourself further.

The *Study Guide* is designed to complement, not replace, *Business Today, Seventh Edition*. There is no substitute for reading the text; in any event, we feel that you will enjoy reading the text. We wish you much success as you begin your Introduction to Business course.

Approaching Your Introduction to Business Course: Study Hints and Test Strategies

You are about to begin a course in modern business practices. Maybe this is your first course in the subject. As you examine your copy of *Business Today* and this *Study Guide*, you may wonder how you will be able to digest all of the information they contain.

Keep in mind that no one expects you to memorize all of the information in a textbook that's more than 600 pages long. In fact, one of your first tasks as a student is to learn to identify the most important terms and concepts and to work on mastering them.

Mastering these concepts takes work. That's inevitable. However, there are techniques you can use to study more effectively. These techniques will help you increase your comprehension while you read, and they'll help you remember what you've read. Ultimately, they'll allow you to cut down on your study time.

You may find it helpful to understand a little of the theory about why this study method works. Research has shown that six factors increase your memory and comprehension:

1. Pattern recognition
2. Repetition
3. Multiple modality learning
4. Paraphrasing
5. Association
6. Understanding the purpose

PATTERN RECOGNITION The human mind is designed and taught to organize information according to certain patterns. When you are faced with something that's completely new or unexpected, it's hard to understand until you know how to categorize it.

For example, suppose a group of people witness an accident. If you interview the witnesses, you will usually get a number of confusing and contradictory versions of what occurred. That's because an accident usually happens suddenly; the witnesses are not prepared for it. If you tell people that they are about to watch an accident and will be asked to give a report on it, you will get a much more uniform description. The witnesses know what kinds of things to look for. They have a pattern of events in mind.

Source: Prepared by Amy Roberts; updated by McGraw-Hill, 1992.

When you are studying, you are more likely to understand and retain information if you know what is coming and how it will be organized.

REPETITION Repetition is easy to explain. From your own experience you know that the more often you see or hear something, the more likely you are to remember it.

MULTIPLE MODALITY LEARNING This fancy term describes something very simple. We perceive things through all our senses. But the brain stores different kinds of memories in different places. Memories of what we see are stored in one place; memories of what we hear are filed in another.

Research has shown that your ability to recall something increases if you experience it through many senses simultaneously. You might have noticed that you tend to forget information that you hear a teacher say, but you remember it if the teacher also writes it on the board. That's because you see and hear it at the same time; your brain processes the information and stores it in several places. This is what is meant by multiple modality learning.

PARAPHRASING Paraphrasing means putting something into your own words. Recent psychological studies have shown that in order to remember something for longer than a few hours, it must be stored in the long-term memory. In order to put an idea in the long-term memory, you must first translate the idea into your own words so that you really understand it.

ASSOCIATION Our minds tend to group information so that we mentally connect one thing to another. For example, you might associate a song with a particular period in your life. Whenever you hear that song, you automatically remember that time. Associating an idea with a visual image or a concrete example increases your memory of it.

UNDERSTANDING THE PURPOSE It's hard to put your heart and mind into something if you don't understand why you are doing it. This is also true when you read. How can you tell when you've found the right information when you don't know what you're looking for?

► HERE'S HOW TO READ *BUSINESS TODAY*

1. Before you start the chapter, read the "Outline" in the *Study Guide*. This will show you how the chapter is organized, which concepts are most important, and in what order they will be presented. (Pattern recognition)

Also read the list of key terms preceding the "Key Terms Exercise." Although you probably won't understand or remember them at this point, your mind will automatically focus on them when you see them again in the text. (Repetition)

Go back to the textbook. Look at the pictures and other visual aids, and read the captions. These captions emphasize many of the most important ideas in the chapter. (Repetition) You will begin to form an image to go along with these ideas. (Association)

Finally, read the "Learning Objectives" and the "Review Questions." (the "Objectives" appear in both the text and *Study Guide*; the "Review Questions" are at the end of each chapter in the text). These features tell you the questions you should be able to answer when you have finished reading the chapter. (Understanding the purpose)

2. Now estimate how long it will take you to read the chapter. Be realistic. When you read, try to keep up the pace so that you finish within your expected time. Most students find that slight pressure like a time-goal forces them to concentrate more.
3. Now begin reading, and keep your mind engaged. Reading is not a passive process. You should be duplicating the authors' thinking in your own mind and explaining the concepts to yourself so that you will remember them. (Paraphrasing)

Read to answer the review questions and learn the terms listed as key words. When you find a definition or an answer in the text, underline it. Then repeat the explanation out

loud. That's right! Talk to yourself! That way you'll see, hear, and say the information you need to know. It goes into your memory through three different channels, and it will stick. (Multiple modality learning)

Here's an extra hint: After you have found and underlined an answer, you may want to write the number of the question in the margin. Then go to the review question at the end and write the number of the page that contains the answer. When it comes time to study for a test, you'll be able to find the information much more easily.

4. After you've read the chapter, carefully read the "Major Points to Remember" in the *Study Guide*. Everything in this summary should now be completely familiar to you. After reading each point, cover it up and repeat it to yourself in your own words. If you can't explain it, you don't really know it.

If you're not satisfied with your own explanation, reread the concept or term you're trying to memorize, and this time write it down. This should plant it in your memory for good. (Multiple modality learning and Repetition)

5. Test yourself. Select one or two of the tests in the *Study Guide*. Check your answers. Write down anything that's still giving you trouble.
6. Retest yourself a week later. Take just ten minutes and try another quiz in the *Guide*. If you can answer the questions after that much time has elapsed, you really know your stuff. You'll find that you'll need much less time to study when you have to prepare for a major test.

One more study hint: Get to know your textbook. Examine the extra features, such as:

Glossary—Key ideas are briefly defined and page numbers are given for further information. Key terms are defined in the margins of the text as well.

Text References—This is a bibliography of the sources the authors used to gather information for *Business Today*. Do you have a research paper to write? This section lists the names of books and articles you may want to read.

These are just some of the features of your textbook. You paid for it—now take advantage of it!

► SELECTIVE READING

Good readers don't read at one steady rate. They speed up and slow down depending on the importance of a particular point. How do good readers know when to read faster or slower? They pay attention to certain signal words that the authors use to guide the readers.

Do you know how to use signal words effectively? Read the following passage and notice all the clues the authors have used.

Cause and Effect Signal

Extremely important in courses where you are supposed to know *why* something happens. *Slow down!* Other signals are *so, so that, because, consequently, therefore, thus.*

Summary Signal

An important point is restated or summarized. *Slow down!* Other signals are *finally, in sum, to summarize, in conclusion, in brief, looking back.*

The business that wants to sell a product and the customer that wants to buy it normally have a relationship based on healthy skepticism. The relationship is aptly captured in two familiar mottoes: "There's a sucker born every minute" and "Let the buyer beware." They reflect the traditionally and widely held view that people trying to sell things for profit are not necessarily to be trusted and conversely, that customers have only themselves to blame.

During the 1960s, *however*, a growing number of people began to challenge the survival-of-the-fittest approach to business-customer relations. With increasing success, consumerists campaigned for greater frankness and accountability on the part of business. They demanded that consumers be protected from useless, inferior, or dangerous products, from misleading advertising, and from unfair pricing. *As a result*, producers and consumers alike became more aware of a variety of safety problems. Pill containers, for instance, were redesigned so that children could not open them. Television sets were made more shock resistant and radiation free. Plastic bags used by dry cleaners were made with holes so children could not suffocate themselves accidentally. In 1972, Congress created the Consumer Product Safety Commission, which took over the responsibility for implementing *such* existing laws as the Flammable Fabrics Act, the Federal Hazardous Substance Act, and the Refrigerator Safety Act of 1956. Recent important actions by the Commission *include* banning asbestos in certain items, *like* manufactured fireplace logs, and banning benzene in materials *such as* paint thinner and rubber cement. The Commission also has the authority to recall specific production batches and to develop uniform standards for consumer products. *Ultimately*, it plans to develop other safety standards for some ten to twelve thousand products.

Contrast Signal

Indicates a change of idea. *Slow down!* Other contrast signals are *but, unlike, in contrast to, in spite of, on the other hand, although, yet, nevertheless, even though, whereas.*

Example Signal

Examples are used to illustrate important points. If you understand the concept, *speed up!* Other signals are *one kind, for example, sometimes, in this case, especially.*

There is one other kind of signal that you should watch out for as you read *Business Today*. Business tends to evaluate a person, product, or system by how well or badly it performs. Throughout this text you will see the words *advantages* and *disadvantages*. They point out the good and bad aspects of the topic. Other signal words with a similar meaning are *pros* and *cons*, and *benefits* and *costs*.

► GENERAL RULES FOR TAKING TESTS

1. When you first receive a test, look it over thoroughly. How many sections are there? How long is it? How many points is each question worth?
2. Read the directions carefully so that you know which questions require more complete answers.
3. Next, mentally note which questions will be easy to answer and which will be harder. Take a minute to plan your attack. Decide the order in which you will answer the questions and budget your time accordingly.
4. If an exam offers you options and allows you to answer some questions and leave others out, make a tentative decision at the beginning. Mark the questions you plan to answer. If you have any doubts about which questions to answer, leave them till later when you can spare a moment to think about them more.
5. Always answer the questions you know first. This way you are sure to get all the easy points. It's not worth puzzling over the hard questions and running short of time for the easy ones.
6. Unless the instructor tells you otherwise, always choose an answer on an objective test and write something on a short answer or essay test. You cannot possibly get credit if you leave the question blank.
7. Be smart. Go to all of the classes the week before a big test. Most instructors will give you hints about what will be on the test. They don't want to see you fail. That makes it look like they aren't teaching you anything!

► HOW TO TAKE AN OBJECTIVE TEST— TRUE-FALSE AND MULTIPLE CHOICE

1. The first thing to remember is that you always have a 50 percent chance of getting a true-false question right even if you guess at the answer. Therefore, always choose an answer.
2. The same principle applies to multiple choice tests. If there are four questions, you have a 25 percent chance of guessing correctly. The odds are much better if you can eliminate one or two choices. Therefore, always make a guess.
3. The only time guessing is not a good strategy is on a national exam like the SAT or the GRE. Statistical methods used in scoring these tests reveal whether answers were chosen randomly. (Random answers result in a "guessing penalty.") If you are not sure whether guessing will hurt your score on a particular test, ask!
4. Most instructors are interested in measuring what you know rather than tricking you. Therefore, don't outsmart yourself by looking for a trick and ignoring the obvious answer.
5. The wording of objective tests is very important. Under the pressure of a test situation, it is especially worthwhile to read the questions carefully.
6. Watch for negatives (words that indicate the opposite of something), such as *not*, *never*, *except*, and for prefixes that indicate negatives, such as *in-*, *im-*, *ab-*, *anti-*, *dis-*, and *mis-*. For example:

Which of the following is *not* one of the basic principles of pure capitalism?
Which of the following is a *disadvantage* of continuous-process production?
A promissory note *cannot* be transferred to collateral by anyone *except* the one to whom it is made out.
7. Watch out for words that indicate absolutes, such as *always*, *invariably*, *ever*, *never*, *all*, and *only*. For example:

Money is the *only* motivation that can be used to increase productivity.
All of the functions of marketing have to be performed in a marketing system.
8. Finally, watch for comparative statements and questions that require knowing how one thing is related to something else. These usually involve *comparison*, *frequency*, or *quantity*. The list of words that signal when a comparative judgment is needed is a long one. Some obvious

ones are *greatest, least, less, often, more, better, generally, majority, primarily, probably, and few*. Evaluate the meaning of these words carefully before you try to answer the question. For example:

Indexing is *probably* the *safest* approach to playing the stock market.

The answer to the question "What business are we in?" is *usually* formulated in the

Packaging adds *little* value to the product.

9. If you're taking an objective test, you'll probably get the best results if you proceed in the following way.

First, read an item through quickly and with high concentration. Answer the question on the basis of your first impression. Then reread the question asking yourself what it really means and express the thought in your own words. (Paraphrase)

Now ask yourself if your original response still seems correct, even after your careful inspection of the wording. Do not change your answer if you're not sure. Change your answer only if you misread the question or if you are now positive that another response is better. When students change their answers, their new answers are incorrect in 70 percent of the cases.

► HOW TO ANSWER AN ESSAY QUESTION

1. Read the question carefully, paying particular attention to the words that indicate what your answer should include. For example:

What types of goods are sold in the consumer market? What types of goods are sold in the business market? How are these goods different? Define each type of good for each market and give an example of each.

This is a complicated question because it is really many questions. You are first asked to generalize and explain ("What types of goods?"). You are asked to contrast ("How are they different?"). You are asked to define and then to give examples.

Make sure you understand the directions before you do anything!

2. Before you start to write, do some brainstorming on a piece of scratch paper. Jot down specific details, such as facts and examples, that help answer the question. On an in-class essay, you don't have the time to tell everything you know about a subject, so choose the best examples.
3. Think before you write. Make a quick outline to force yourself to organize your thoughts and be sure that you've included everything necessary.
Even if you don't write a formal outline, decide on the order of what you are going to say. For example, you may decide to discuss the causes of something and the results and then to give your opinion.
4. Now write out your answer, being sure that you stick to the topic and the plan you have made.
5. Always take a minute to reread what you've written. Leave enough room where you write so that you can add things later.
6. Spelling and punctuation may not count so much on an in-class exam, but a clear, clean answer always makes a better impression than a sloppy one. It suggests that you are organized, confident, and in control of the situation.

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Chapter 1

Foundations of American Business

LEARNING OBJECTIVES

1. Explain what an economic system is.
2. List the four factors of production.
3. Name the three major types of economic systems and differentiate their identifying characteristics.
4. Describe the relationship between profit and sales, and explain how profit motivates entrepreneurs.
5. Discuss three ways companies compete.
6. Explain how supply and demand interact to establish prices.
7. List the four major economic roles of the U.S. government.
8. Identify six trends that will influence the economy in the years ahead.

OUTLINE

- I. The ideal of economic freedom
 - A. The nature of economic systems
 1. Factors of production
 2. Economic goals and measurements
 - B. Types of economic systems
 1. Capitalism
 2. Communism
 3. Socialism
- II. Economic forces affecting business
 - A. The profit motive
 - B. Scarcity and opportunity cost
 - C. Competition
 1. Competition and price
 2. Competition, quality, and service
 3. Competition and innovation
 - D. Supply and demand
 1. How prices are set
 - a. Demand curves, supply curves, and equilibrium price
 2. How prices affect whole industries
 3. How prices affect labor decisions

2 Part One: Focus on Business Today

- E. Circular flow
- F. The multiplier effect

III. The role of government

- A. Enforcing rules and regulations
- B. Providing public goods and transfer payments
- C. Fostering competition
 - 1. Types of competition
- D. Contributing to economic stability
 - 1. Recession, business cycles, fiscal policy, and monetary policy
 - 2. Employment and unemployment
 - a. Employment and the business cycle
 - 3. Inflation and disinflation
 - a. The effects of inflation
 - 4. High and low dollars
 - a. National monetary policy

IV. Shifts in the economic climate

- A. The history of the growth in the U.S. economy
 - 1. Capital accumulation and increases in the power of business
 - 2. Increases in foreign competition
- B. The challenges ahead
 - 1. The global economy
 - 2. Accelerating technological development
 - 3. Environmental concerns
 - 4. The changing labor force
 - 5. Participative management
 - 6. The evolution of the service sector

MAJOR POINTS TO REMEMBER

1. An **economic system** is a set of rules used to allocate a society's resources to satisfy its citizens' needs.
2. The resources of a society are known as its **factors of production** and include natural resources (e.g., land, forest, minerals, water), labor, **capital** (money, machines, tools, and buildings), and **entrepreneurs** (people who develop new ways to use economic resources). In the United States, entrepreneurs are willing to risk their personal resources when they start a business because if it succeeds, they get to keep the rewards (i.e., profits).
3. The dollar value of all the final goods and services produced by an economy in a year is known as **gross national product (GNP)**, and it is the traditional way that has been used to forecast trends, analyze economies, or compare two or more economies. The latest method used to track an economy is **gross domestic product (GDP)**. Like GNP, GDP measures the total output of goods and services, but GDP also includes profits from foreign-owned businesses operating within U.S. borders (excluded in GNP) and excludes receipts from the overseas operations of American companies (included in GNP). A rise in GNP or GDP is a sign of economic growth.

4. GNP and GDP may at times be misleading, due to differences in population size, so per capita GNP (a country's GNP divided by its population) is often calculated. But even per capita GNP fails to reveal anything about the way in which income is distributed among the people. Additionally, the **underground economy** is not included in GNP figures. The underground economy includes revenues from illegal activities (e.g., gambling, prostitution), under the table payments, and **bartering** (trading goods and/or services directly, rather than paying with money), and may have been worth as much as 15 percent of GNP in 1990.
5. The three main economic systems are **capitalism**, **communism**, and **socialism**. In the eighteenth century, Adam Smith described an economic system called **pure capitalism**, in which all production and allocation decisions would be made by private holders of property or money, on the basis of prices set by the free market. But in the United States, the government is allowed to use its power to affect prices or change the way resources are allocated. The U.S. system, therefore, may be called **mixed capitalism**.
6. Capitalist economies operate under a **free-market system** and are therefore often called **market economies**. This means that an individual with something to sell is free to charge any price and sell to anyone willing to pay this price. As buyers, we are free to purchase whatever we want and can afford.
7. Communism allows individuals the least degree of economic freedom. It is characterized by state ownership of the factors of production and by planned resource allocation. In this type of **planned economy**, social equality is a major goal and private enterprise is considered to be wasteful. Under communism, there is less of a gap between the rich and the poor, and unemployment and inflation can be more easily controlled. However, there is little incentive to develop more efficient and productive methods.
8. In the past few years, more and more communist countries have relaxed the central control of their economies and have encouraged individual initiative. In Eastern Europe, the shift away from communism has been especially dramatic, with many countries now embracing the principles of capitalism. East Germany (now reunited with West Germany), Poland, Hungary, Romania, Czechoslovakia, and Bulgaria are all moving to market-based economies. The former Soviet Union died in December 1991, as eleven republics formed the Commonwealth of Independent States (CIS) and pledged to move to a market-based economy, private ownership of property, and decentralized planning. Even businesspeople in China have made small but steady steps toward a more market-based economy (although people are fleeing Hong Kong in record numbers because the territory will revert to Chinese control in 1997).
9. Socialism also involves a high degree of government planning, as well as some government ownership of land and capital resources in industries viewed to be vital to the common welfare. Elsewhere, however, private ownership is permitted to exist. Citizens are typically taxed heavily in socialist states, because the government pays for medical care, education, housing, and other social services.
10. A number of socialist countries, like some communist countries, are presently moving toward capitalism. Mexico and Chile, for example, are selling off state-owned businesses, while some South and Central American nations are benefiting from the open-market economies they created in the 1980s. Around the world, both communist and socialist countries are becoming more capitalistic because they are impressed with the prosperity that seems to accompany the free-market system.
11. Economic forces affecting business include the profit motive, with **profit** (i.e., the difference between what someone is willing to pay for an item and its manufacturing and marketing costs) being the foundation of the United States' economic system. Scarcity (i.e., resources are scarce—for example, an individual or a business has only a certain amount of money) and **opportunity cost** (i.e., if you spend an amount of money in a particular way, that money is no longer available to be spent on something else) are also facts of economic life, as is competition.
12. An entrepreneur may wish to compete on the basis of price, quality, service, or innovation. An illustration of competition and price is when one gas station charges two cents less per gallon for unleaded regular gasoline than its competitor across the street. Rather than cutting price, though, a business may decide to attract customers by offering higher-quality goods or better services than its rivals. Yet another entrepreneur might compete by offering a more innovative product than the competitors.

13. Another economic force that can determine price levels is supply and demand. **Supply** refers to the quantities of a good or service that producers will provide on a particular date at various prices. **Demand** is the amount of a good or service that consumers will purchase on a given date at various prices. The theory of supply and demand states that people will be willing to pay a higher price for something they want very much, and, at this higher price, producers will be willing to provide more of the item (i.e., the more money a producer can get for a product, the higher the quantity he is willing to produce). Conversely, an item that is in abundant supply will be sold at a lower price. The forces of supply and demand, in conjunction with the profit motive, regulate what will be produced and the amount that will be produced in a free-market system.
14. The price that will make both the supplier and customer happy is set when the number of units of a product or service demanded equals the number supplied. The relationship between price and quantity demanded is often presented on a graph. A **demand curve** is the line showing the relationship between price and quantity demanded; a **supply curve** traces the relationship between price and the quantity supplied. The price at the point where the demand curve and the supply curve meet is known as the **equilibrium price** (the price at which the quantity demanded is equal to the quantity supplied).
15. The law of supply and demand also applies to labor. Individuals use the price of work, measured in salary or wages, to choose among different available jobs. Consequently, an industry must price its jobs properly if it is to attract workers.
16. While the law of supply and demand should, theoretically, operate just as well on a global scale as it does on a national scale, in reality it does not. Many major industries require huge facilities that can produce more than enough to meet domestic demand (because larger facilities are more efficient than smaller ones). To keep such plants in operation, some governments pass protective trade laws to keep out competing goods. Governments may also provide financial help to boost export sales.
17. Perhaps the most important economic concept affecting society as a whole is the **circular flow**, a term used to describe the movement of all resources within the economy. The economy carries goods and services one way and money the other. Goods and services flow from businesses or government to households (or other businesses), and households provide a return flow of money or taxes for these goods and services. Households also provide businesses with labor, in exchange for wages and salaries.
18. The process of saving and investing is also a part of this circular flow and is central to the economy's growth. Hence, it is feared that the decline in the household savings rate in the United States in the past few years may adversely affect the economy.
19. As companies do business on an international basis, they build factories in other countries, employ foreign labor, and obtain foreign capital. Consequently, what happens to the U.S. economy may depend on what happens in other countries.
20. Because the circular flow links each economic activity to all others, any change in one part of the economy creates some changes elsewhere. The pattern whereby all economic decisions ripple through the system is known as the **multiplier effect**.
21. Government is the final force affecting the economic system, and its laws help protect and enhance the economy, rather than just limit it. The government enforces rules and regulations, provides public goods and transfer payments, fosters competition, and contributes to economic stability.
22. The federal government creates new rules and regulations at the rate of 4,600 a year, with state and local governments adding even more. For example, you can't drive a cab without a license or open a restaurant without a certificate from the board of health. Companies and individuals must also share their profits with the government, whether they be in the form of wages, interest, or lottery winnings.
23. The government uses tax money to provide **public goods**. Examples of such public goods include roads and police protection. Additionally, from tax revenues, the government helps less self-sufficient individuals with

food stamps, Social Security, welfare, and unemployment compensation. These **transfer payments** do not require that the recipient provide anything in return.

24. Laws have been passed to foster competition (i.e., to see that a particular company does not become too powerful) because it is believed that competition benefits the economy. **Pure competition**, in which no single firm or group of firms in an industry is large enough to influence prices, is the theoretical ideal. Few industries, however, work this way, but it can work in industries in which economies of scale do not favor large manufacturers. **Oligopoly** exists when a few large companies dominate an industry (e.g., the U.S. auto industry). **Monopoly** is the situation in which one company dominates a particular industry or market, fixes prices, and keeps other companies from competing. Because this is contrary to the principle of competition, monopolies are prohibited by federal law (some monopolies, like utilities, are legal but closely regulated).
25. Where economies of scale provide an advantage, many foreign governments prefer having only one or two major companies in an industry. They believe that these large firms will be more competitive in the world marketplace.
26. The U.S. economy is constantly changing and may shift from periods of growth to **recession** (a period in which the economy contracts). These swings are known as the **business cycle**. The government attempts to influence the economy through its **fiscal policy** (i.e., juggling revenues and expenditures to stimulate or dampen the economy) and **monetary policy** (i.e., adjusting the nation's money supply) in an effort to lessen the impact of periods of economic decline.
27. Unemployment may become a major social problem during periods of economic downturns. By manipulating fiscal policy, the U.S. government spends money to keep businesses in operation and people working. However, recent economic conditions make it more difficult to intervene in the business cycle. Because the government is spending more than it takes in, any increase in government spending might actually make the situation worse.
28. **Inflation** exists when the prices of goods and services rise steadily throughout the economy; a reversal of this rise is **disinflation**. When inflation is high, people borrow money to buy goods and services before prices rise even further, and slowing high inflation becomes very difficult. Nevertheless, the federal government was able to bring about a period of disinflation during the 1980s. This was made possible by a weakening of the oil **cartel** (an association of producers that tries to control a market and keep prices high by limiting production), a deregulation of American industry, a decline in the power of labor unions, and a limit on the amount of money put into general circulation.
29. Another way the federal government tries to stabilize the economy is by juggling the value of the dollar relative to foreign currencies. A high dollar makes foreign goods relatively cheap for Americans and U.S. goods relatively expensive for foreigners. The nation's monetary policy helps determine the value of the dollar. For example, when the government tightens the supply of money, interest rates rise and inflation falls. Conversely, during the 1990–1991 recession, the government loosened up on the money supply and interest rates fell. This action pushed down the value of the dollar and resulted in a rise in U.S. exports to other nations.
30. The history of the United States has witnessed a number of shifts in economic growth. In prerevolutionary times, and for many years thereafter, the U.S. economic base was the small family farm. By the early nineteenth century, greater use of rivers, harbors, mineral deposits, and other natural resources allowed the accumulation of capital needed to increase production. This process of **capital accumulation** was aided by the fact that Americans believed in saving.
31. By the mid-nineteenth century, the United States was changing from an agrarian to an industrial economy, with independent artisans being replaced by large factories, mass production, and the division of labor. In the early 1900s, the government passed laws and regulations to stop the abuse of power by big business, and workers began to organize into labor unions. The Great Depression of the 1930s disenchanted Americans with the power of business to solve the country's economic problems.