

**BUSINESS MANAGEMENT**  
**AT SMALL BUSINESS**  
**SMALL BUSINESS**  
**MANAGEMENT**  
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**THIRD EDITION**

**William D. Hailes, Jr.**  
**Raymond T. Hubbard**

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**THIRD EDITION**



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**William D. Hailes, Jr.  
Raymond T. Hubbard**

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# PREFACE



The economics of our country is sometimes thought of as being dominated by giant corporations with profits in the millions. A characterization such as this one ignores the important role of small business in society. Each year in the United States over half a million new businesses begin operation. Many succeed, while others fail. The purpose of this text is to examine small business practices and to identify those factors which contribute to the success of a small business.

*Small Business Management* introduces the prospective small business owner to the principles of small business planning and operation. The text explains basic areas of business, ranging from a description of opportunities in a free society to an appraisal of the future for small business. Individuals involved in secondary, vocational, two-year college, and adult education programs, or anyone interested in starting a small business, are given an opportunity to study, discuss, and apply some of the principles and methods successfully used in small business management.

Each unit includes objectives, information, illustrations, and materials which aid the individual in the understanding of the subject. Practical assignments highly relevant to actually starting a small business form the basis of a manual which is completed one assignment at a time. Each unit also contains a unit quiz. The questions are designed to measure the student's comprehension of the material presented. The Instructor's Guide for this text includes model answers to the assignments. However, the emphasis of the assignments is on the results being meaningful to the entrepreneur who hopefully will accomplish most of the planning for a small business while studying this material.

Many persons will be studying this text with the expressed purpose of starting a small business some day or improving a business they may now be involved with. For those persons especially, it is urged that they complete each of the business manual assignments. When the projects are all completed and assembled there will be a comprehensive business guide designed especially for the business chosen, with many of the forms, planning ideas, and problems already worked out. This business manual will greatly simplify the actual process of opening the small business when the time comes. It could also be shown to a prospective employer as evidence of sincerity of purpose in seeking employment for experience, or to a banker in support of a request for a business loan.

Statistical information has been updated in this edition. Two completely new units have been added, one on selecting the right business, and the other on franchises. New information has been included reflecting the constantly changing world of small business. For instance, considerable litigation has ensued recently concerning product liability. This topic is thoroughly discussed, as it will be an important issue for small businesses in the future. Anyone planning to start a small business should be informed about local, state, and federal sources for up-to-date information, rules and regulations, and anything which affects the business. In order to do this, private and public agencies and organizations which can assist the small business owner are mentioned throughout the text.



## ABOUT THE AUTHORS

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William Hailes and Raymond Hubbard have extensive training and experience in business education and in management. Mr. Hailes is a graduate of Rider College and The University of Rochester. He is a business educator, a small business owner, a public school administrator, a curriculum consultant, and has developed many educational materials.

Dr. Hubbard holds degrees from the State University of New York at Binghamton, Syracuse University, and a doctorate from Rutgers University. He has been an instructor and curriculum coordinator at the secondary level and a professor, business division chairperson, and dean at the two-year college level. He is a management education specialist for a large computer firm. Dr. Hubbard also serves as a small business consultant for employee training and management programs.

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# *UNIT 1*

## **SMALL BUSINESS IN A FREE SOCIETY**



### **OBJECTIVES**

After studying this unit, you will be able to

- Describe the free enterprise system.
- Explain the difference between big business and small business.
- Explain the need for rules and regulations in businesses.
- Define the Terms to Know.



## WORKING FOR YOURSELF OR OTHERS?

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When Sam was in high school, he learned to operate an engine lathe in a vocational machine shop program that his school offered. Even before he was graduated, Sam was working as a beginning machinist in a small shop on a cooperative work-experience program, which helped him learn on the job while still in school. After graduation, Sam stayed on at the machine shop and began an *apprentice* program. After six years Sam became a *journeyman* machinist and eventually a master. Sam was lucky, and worked hard, and was quick to pick up changes in his job. As a result, *technological* changes did not really affect Sam too much. He was able to quickly learn the new machines and procedures as they came along.

The small machine shop grew and became a large manufacturing plant. Sam was offered promotions many times. He refused the promotions on the grounds that he did not want the responsibility. Sam earned good wages over the years. During World War II, he was exempted from military service because the plant was a large defense contractor. After 47 years with the same company, Sam retired. He lives with his wife in Florida on a comfortable pension, and sees his seven grandchildren from time to time.

There are a lot of people like Sam, who want out of life only a steady job, fair wages, and a chance to retire on a decent income. Sam was fortunate. His plant never laid him off, and he was able to save over \$5,000 in savings bonds on the payroll savings plan at work. Sam has what many people call *security*.

Take on the other hand, Irving. Irving was a poor student in school, at least academically. In those days, all he was interested in was cars. The school Irving attended did not have a vocational program, so he could not get proper training in auto mechanics. Because of poor attendance, due to staying home to work on his car, Irving finally dropped out of high school. Eventually, Irving had to find work. At the height of the Great Depression, all he could find was a floor-cleaning job at a large auto and truck garage. The job was extremely dirty and hard. The pay was low, but, Irving stayed with the job for five years. During that time, he watched the repairmen and because he was quick to learn, like Sam, they showed him how to repair engines, among other jobs.

One day Irving noticed that they threw out broken parts, usually without trying to repair them. He asked his foreman if he could have the old carburetors, generators, and fuel pumps to work on. He promised not to do the repairs on company time. The foreman agreed, and soon Irving had repaired dozens of engine parts. He began selling the repaired parts on weekends to other garages and shops in town. Irving was a natural repairman. When he repaired a part, it usually worked fine and was inexpensive compared to a new part. His reputation for reconditioned parts earned him much more money for part-time

work than his regular job did. Irving soon decided to quit his job with the garage and work full time repairing used auto parts. He rented a shed and traveled to all the garages in town buying their junk parts. In most cases, he got the parts for nothing or for as little as 10 cents apiece. Irving was extremely busy fixing parts. He tried to keep up with the requests for parts from local garages, but decided that he needed help. He hired a person to assist him in fixing the parts and another person to travel to the various garages to pick up the used parts.

About this time, Irving was drafted into the Army during World War II. He wound up in the Engineers working on heavy equipment, trucks, tanks, and half-tracks. When the war ended and Irving was discharged, he had four years of valuable experience working on all sorts of heavy equipment and machinery. Using a GI loan, he started a small parts business. To make a long story short, the business grew rapidly after World War II.

Irving is retired now, living with his wife in Florida. His business grew into a five-state chain of auto parts stores, a manufacturing plant, a reconditioning plant, and several warehouses. Irving incorporated the business in 1950. The last year he was actively engaged in the business, it grossed seven million dollars in sales. Irving gave his two sons complete control of the business, and they appear to be running it well. Irving lives well in the southern climate, draws a six-figure salary as chairman of the board, and still tinkers with automobiles, only this time, just for fun!

If you are more like Irving than Sam, you may want to think about working for yourself, rather than for others. Working for yourself is what this book is all about.

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## THE FREE ENTERPRISE SYSTEM

Most countries operate within an economic system that provides or attempts to provide its people with necessary *goods* and *services*. Many countries use the capitalist system to fulfill these needs. In the capitalist system, there is much less government interference in the operation of businesses than with other economic systems such as the socialist system. It is important to understand some of the privileges and responsibilities people have in a free enterprise system. These include the right of property, the right of free enterprise, the right of contract, and the right of profit.

### Privileges in a Free Enterprise Economy

The *right of property* includes the right to own items that are *intangible* (which you cannot feel or touch) and *tangible* (physical). Copyrights, patents,

trademarks, and goodwill or reputation are intangible forms of property. Buildings, machines, and merchandise are tangible forms of property. All of these items owned, both tangible and intangible, are called *assets*.

The *right of free enterprise* allows a person to enter into any business activity that is legal and does not infringe on the rights of others.

The right of profit is the freedom to invest one's own time, labor, and money in an activity in the hope of making a profit. Many people prefer to own a business instead of working for others. If they succeed in business, they feel that their profit and self-satisfaction will be greater than if they worked for others.

An employee works for *wages*, and the business owner works for *profits*. You could say that profits are, in effect, the wages of management. Business owners who undertake the responsibility of risking their assets (capital) in a business are called *entrepreneurs*. From the French, this word means literally "to enter" and "to take" (*entre* + *prendre*) presumably, a profit. Profit is what motivates entrepreneurs to risk capital. These risks are sometimes great. Without the *profit motive*, few would risk their money. The free enterprise system is based on this willingness of individuals to risk their accumulated wealth in the hope of making profits. This system is called *capitalism*.

The *right of contract* allows two or more persons to enter into a legal agreement. If one party fails to live up to the contract, the other parties may obtain satisfaction through the court system. Contracts can be enforced by law. If this were not the case, there would be a general lack of confidence among people in business and it would be hard to carry on business.

## Responsibilities in a Free Society

When the U.S. was largely unsettled and had a small population, almost any kind of business could be started without the government's permission. Since travel was hard and slow due to poor roads, each community provided many services for itself. Each town had its own local blacksmith shop, barrel maker, cobbler, and furniture maker. Factories and mills employed people from the village and the owner personally knew each worker.

As the country's population grew, the methods of production and transportation improved. Machinery was used to supplement hand labor in manufacturing. Factories employed hundreds of people, and villages and towns became cities. Owners could no longer personally know each person they employed.

It became necessary to hire persons to assist the boss. As a result, managers and supervisors were added to oversee the work of others. The growth of industry led to a number of practices requiring restraints. In some cases, factories employed children and women who worked long hours at dangerous jobs. Workers were often badly treated and some were injured by moving machinery. People

realized that laws were needed to prevent child labor abuses and to improve working conditions.

Laws have been passed to prevent labor abuses and to provide payment for workers injured on the job. Wages and working conditions have also improved. To protect consumers, laws now require businesses to get licenses and permits in order to conduct certain businesses. Various products must be labeled showing ingredients or materials, quantity, and origin of manufacture. Business establishments are now inspected for cleanliness and safety.

Though certain standards are required by law, business owners now realize that it is good business to provide good working conditions for employees. Owners must depend on workers who are treated fairly to provide the high-quality goods and services at a reasonable cost which permit them to compete successfully in the marketplace. This spirit of working together for a common goal is the factor that underlies our democratic free enterprise system.

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## **SMALL BUSINESSES — WHAT ARE THEY?**

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Numerous definitions of the term *small business* exist. The Small Business Act of 1953 states that a small business is “one which is independently owned and operated and not dominant in its field of operation.” The Small Business Administration traditionally uses the following criteria for defining small business:

- Retailing — sales volume
- Service — sales volume
- Wholesaling — sales volume
- Manufacturing — number of employees

The definition varies depending on the government agency. Such agencies as the Small Business Administration, Committee on Economic Development, and Federal Reserve Bank have different definitions. Their size standard for small business continuously changes in order to meet the needs of our changing economy.

If a business is considered small by the appropriate governmental agency, it may qualify for a number of government services. Some of these services include access to federal loans, management assistance, and first chance for certain government contracts.

### **Measuring Business Size**

The following is a list of terms that can be used to describe a business. Each term tells something about the size of a business.

- Total assets — all that a business owns
- Net worth — business assets less what is owed



- Gross profits — money left from sales after all expenses (except taxes) have been paid
- Net profits — what is left from gross profit after business income taxes are paid
- Employees — total number of workers and managers listed on the payroll
- Income — net receipts, the total sales less returns, allowances, and discounts

It is necessary to keep records of a business for tax purposes and as a measure of growth. Some businesses fail because they are improperly expanded. Other businesses are unsuccessful because they expand too quickly and cannot handle the problems that come with rapid growth. Many businesses remain small and provide excellent income throughout their lifetime.

Big business is not bad because it is big. Unethical practices that occur in small or in large businesses must be stopped. Honesty does not depend on size. Some people distrust big business because it is large, complex, and hard to understand. Some small business owners resent the larger companies because they feel they have an unfair advantage. This is not always true. As the size of a business increases, so does its problems. Because government help is available it is easier to operate a small business than a large business. Small business owners who complain that large businesses are giving them unfair competition have not yet found ways to use the advantage of flexibility unique to them.

## The Importance of Small Businesses

A great number of kinds of small businesses are possible. It is therefore difficult to decide how you fit into the business world considering your plans, your preferences, and your abilities. Whatever choice is made, it is important that you are fully prepared for it. In Unit 2, several different types and kinds of businesses are explained. Several choices are available, many that you have probably not thought of thus far. So, making a decision, one of the most important in your life, seems most confusing.

Being aware of some of the facts about small businesses and their importance may make you feel better about a decision to own a small business. A few people believe that the contribution of small business to the nation's economy is relatively unimportant. Nothing could be further from the truth, Figure 1-1. According to the Small Business Administration of the U.S.:

- 95% of all businesses in the U.S. are small.
- 43% of the total business volume in the U.S. is done by small businesses.
- 51% of the civilian work force in the U.S. is employed by small businesses.\*

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\**Small Enterprise in the Economy*, U.S. Small Business Administration, Office of Advocacy, Planning and Research, Washington, D.C., 20416, March 1975.



**FIGURE 1-1**  
A business does not have to be large  
to be successful.

Small business plays an important role in our economy. Therefore, the choice that you make is important, for your own sake and also for the country. Several lists of small business possibilities can be found in Unit 2. Study the possibilities carefully, and make sure you understand what each business is. The businesses listed are only suggestions. The list is not intended to be complete, since thousands of choices exist. Since over half a million new small businesses are started every year, there is quite a variety. You should begin now to think of a part-time or full-time business that will challenge your imagination and motivate you to do the planning for it, Figure 1-2. If you are serious about starting a business now or in the future, this project can be the most important one you will ever undertake.

Choosing the right business is an important and difficult task. Many businesses fail because they never should have been started. The person starting a business can either buy an existing business, start a new business similar to ones already operating, or start a completely new kind of business. The buying of an existing business is discussed later in the text. Before a potential proprietor can research a



**FIGURE 1-2**  
Child care services is an excellent example of a small business that can be operated part-time in the home with little outlay in capital. The building must be inspected, and a license is required.

business, however, that person must have an idea of what type of business is desired.

There are a number of steps you can follow in order to choose the right small business. First, analyze your own strengths, weaknesses, and interests. Write down on a piece of paper the work-related experiences you have had in the past. Then identify those experiences you enjoyed most and those you enjoyed least. From this exercise, you should be able to identify types of businesses that are similar to what you like to do.

## **RESOURCES FOR SMALL BUSINESS IDEAS**

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Some people know exactly what business they want to start. Others need to search for a business that will be successful. The two basic research activities that follow have worked for several people.

Read the following publications:

- Newspapers. Most daily and all Sunday papers have business opportunity sections.
- Trade papers and periodicals. At least one publication exists for every trade. Most of the publications cover trends and market information for the present and future.
- Economic studies in your area. These studies are usually found at the local chamber of commerce.
- Business journals. These publications discuss trends and opportunities. Many states and large metropolitan areas have their own business publications.

Talk to the following people:

- Bankers, accountants, business consultants and lawyers. These professionals are able to help potential proprietors assess their abilities. They may also know of individuals who have businesses to sell.
- Business brokers, realtors, industrial developers, and chamber of commerce representatives.
- Friends, relatives, and prospective customers. These individuals are able to react to suggested needs that could be met by a potential business.

The prospective new business owner should talk to as many people as possible. Always keep in mind that it is important to choose a field that meets a customer's need and has growth possibilities. Without the possibility of growth, a new business will be short-lived.

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## **RULES AND REGULATIONS**

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Would a baker living in London 400 years ago have had to obey some of the rules and regulations which exist today? The answer is yes. The baker could not have started a baking business without the permission of the other bakers in town. The size of the loaf, its ingredients, the amount it was sold for, and every other aspect of business would have been subject to very specific regulations. Thousands of years ago in ancient Babylonia, records show that businesses were bound by numerous rules or laws. In many ways, business persons today have more freedom to open a new business or market a new product than their predecessors throughout history.

Nevertheless, the list of regulations grows. More rules are made and more reports are required, and they are getting more complicated. The services of a lawyer, an accountant, or a tax expert are often necessary to fill out forms and meet the requirements of the laws. Some people feel that free enterprise is being restrained by rules, regulations, and reports. Why should there be so many regulations and why should they continue to grow in complexity?



## Regulations are Needed

The following example illustrates the need for certain rules and regulations in business operation. Before opening a restaurant, many inspections are made to insure standards in safety. The electrical wiring, refrigeration, water, and sanitation must all conform to current requirements. The proper licenses must be obtained, a minimum wage must be paid, and children who are under age may not be employed.

Business owners might wonder why the government does not trust their good sense and honesty. Unfortunately, some individuals cannot be trusted. A business next door to the restaurant might decide to cut expenses by using defective wiring. If this caused a fire, the restaurant could suffer. Another neighboring business might carelessly dump refuse which would attract animals and insects, creating an odor. Restaurant customers would surely react.

## Protection From a Few

As society expands in size and complexity, more rules and regulations are needed. These rules and regulations are necessary if we are to live together in harmony and with maximum individual freedom.

The profit motive results in improvements for society by causing competition, which in turn causes products and services to be improved. Nevertheless, it is also necessary to limit the few people who might make a profit in a harmful way. Most products go through many processes and inspections before reaching the consumer. Federal and state regulations insure that the consumer is protected at various stages of production and distribution. Each state has a consumer protection agency. Consumers can apply to these agencies if they are injured by faulty products, or from malpractice of a service. In the future, it will be necessary to pass even more laws concerning industrial safety, working conditions, retirement pensions, social benefits, product liability, and additional taxes. Laws that limit and direct the disposal of toxic wastes from manufacturing and processing will also be needed.

Regulations originate at various levels of government: local (city, county, town), state, and federal. Trade associations, unions, and companies themselves make rules and regulations, Figure 1-3. A rule or a regulation is often the result of a court decision based on a law which is tested and interpreted by the courts.

City governments pass rules, regulations, and ordinances. The various levels of government issue licenses, permits, and *variances* (exceptions to the general rule). *Codes* are groups of regulations that are classified by governmental departments, such as building codes, sanitary codes, fire regulations, and zoning ordinances.