

# 1

## The Role of Business in Society

### WHY STUDY BUSINESS?

Regardless of your college major, you cannot escape from interacting with businesses and other organizations. Business operations are involved with almost every aspect of your life. More than likely when you graduate, you will be employed by some type of a business. Therefore, it only makes sense that you develop an understanding of how businesses function, regardless of your career choice. The purpose of this book is to give you an overview of some of the main functions of business and to help you make informed decisions today, and in the future.

### THE PURPOSE OF BUSINESS

Businesses exist to make a profit! Businesses make a profit by identifying unmet needs and wants and then developing products and services that will satisfy the unmet needs and wants. The late sales trainer and motivational speaker, Zig Ziglar, once made the comment that “nobody really wants to buy a half-inch drill, what they really want is a half-inch hole.” The point he was trying to make is that successful businesses will focus on the unmet *needs* and *wants* that exist. In this example, the need is for a half inch hole. The product—the drill—is simply a way to satisfy the need. If a half-inch hole can be made more efficiently with something other than an electric drill, then the company that is able to successfully bring such a product to market will have found an alternative method to satisfy customer needs and wants. If such a company is able to sell its product at a price more than the cost of providing the product to the customers, it will do so at a profit, and over time become successful.

Good businesses *begin* by identifying unmet needs and wants. These businesses then develop products and services that will satisfy these unmet needs and wants. Thus, the product and service development is driven by the unmet needs and wants of consumers. The products and services are provided through the business process, using combinations of the *factors of production* as inputs into the business. The factors of production include raw materials, capital, labor, and entrepreneurship (Table 1.1).

**Table 1.1** Factors of Production

Inputs	Process	Outputs
Raw Materials	The Business Process	Products & Services
Capital		
Labor		
Entrepreneurship		

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Needs & Wants
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**Raw materials** include naturally existing resources that are either below ground, on the ground, or above the ground.

**Capital** includes man-made resources such as machines, equipment, and money.

**Labor** include people who work with their minds and people who work with their muscles.

**Entrepreneurship** is the individual or individuals who have the insight to visualize how the other factors of production can be brought together and, through their determination and effort, produce the products and services able to satisfy the unmet needs and wants of customers.

**Capitalism** is the private (nongovernment) ownership of the factors of production.

There are many products that exist today that did not exist 20 years ago; for example, iPhones and iPads. It is sometimes difficult to understand how we could have existed in the past without these products. Several of these new products have made many people very wealthy. Similarly, there are products that will be created 20 years from now that currently do not exist. The products of the future will satisfy currently unmet needs and wants. All the factors of production to make the products of the future exist today. However, it will be the entrepreneurs of the future who will bring together the currently existing factors of production to create the products and services of the future that will satisfy the existing unmet needs and wants. These future entrepreneurs may become very wealthy in the process.

The goal of a business is to be able to sell products and services at a price that is more than the total cost of providing the product or service.

$$\text{Revenues} - \text{Expenses} = \text{Profit}$$

**Revenues** are the monies that businesses receive for selling their products and services to their customers.

**Expenses** are the total costs of making and delivering the product and services to their customers.

**Profit** is the excess of revenues over the expenses.

## For-Profit Businesses

As previously stated, businesses primarily exist to make a profit. It is not the primary goal of a business to make a quality product or create employment. Providing quality products and services are a *means to an end*—profits. When a business is able to successfully identify exactly what it is that its customers really want, and are able to produce that product or service better than its competitor, the business will be rewarded in the form of increasing profits. It is the profit that is the main motivation; the desire to produce the best product or service in the marketplace is simply a means to generating more profits.

Similarly, employing workers who enjoy their jobs and are able to provide for their families are also the by-products of a business, not the primary goal. Creating jobs is not the responsibility of business. Some have argued that job creation is the responsibility of government. Others have put forth the argument that one of the most important roles of government is to create an environment that is supportive of business ventures. Successful businesses will create jobs as they strive to produce goods and services for their customers—in an effort to make a profit.

Therefore, although businesses do create jobs, it is not their primary objective. Consequently, when a business closes down operations in a state such as North Carolina and moves

the processes overseas in an attempt to reduce operating costs, it is simply behaving in a manner consistent with its primary mission. It is the role of government to create incentives that will cause businesses to want to stay in the region and hire employees.

## Not-for-Profit Organizations

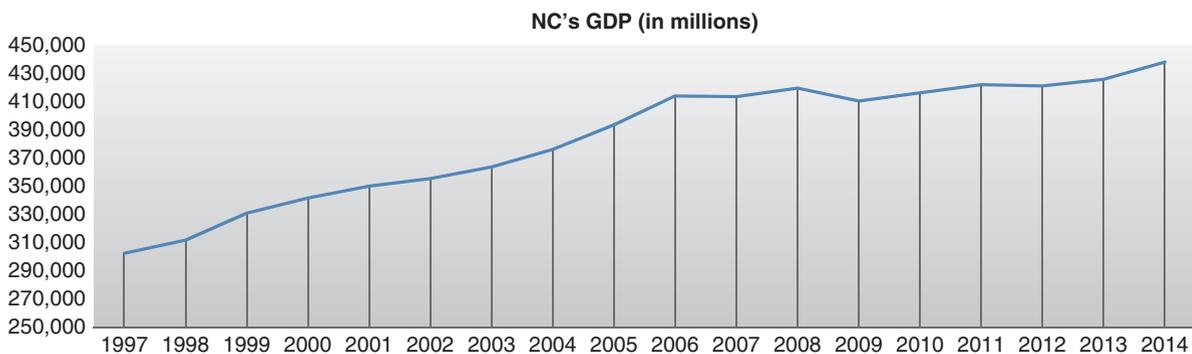
Not-for-profit organizations are entities that may look like businesses from the outside looking in, but are not businesses because their primary goal is not to necessarily make a profit. While the primary goal of a business is to make a profit, the primary goal of a not-for-profit organization is to provide a good or service. Examples of not-for-profit organizations include religious organizations and most private colleges.

It should, however, be clear that simply because it is not the primary goal of a not-for-profit organization to make a profit, there is nothing that prohibits them from occasionally making a profit. As a matter of fact, the long-term financial objective of a not-for-profit organization is to make a small profit in a few years to offset the losses that occur in other years. If, over a period of time, the net profit of the organization equals zero, most would be satisfied as long as they were able to provide the product or service that is their main mission, and did not lose money in the process.

## BUSINESS AND THE ECONOMY

An economy consists of the production, distribution, and consumption of goods and services in a given geographical location. An economy is measured in terms of its gross domestic product (GDP), which is the final value of all goods and services produced in a specific region in a calendar year. The United States is the world's largest national economy, representing 22% of global GDP in 2015. The United States' GDP was estimated to be just under \$18 trillion in 2015. In 2014, North Carolina's GDP was \$483.1 billion and ranked ninth in the United States. The past decade has seen an increase in North Carolina's GDP. In 2004, North Carolina's GDP was \$332.6 billion and ranked 11th in the United States (Figure 1.1).

Businesses play an important role in the functioning of national and state economies. It is businesses that create, produce, and distribute much of the goods and services within an economy. Businesses provide jobs that allow residents the financial resources to purchase



**Figure 1.1** North Carolina's real GDP

Source: Courtesy of Devon Hall.

consumption goods. The more jobs people have, the more money they have to purchase goods and services. The more goods and services that are needed to be purchased, the greater the need for businesses.

Governments obtain their revenues through taxes. Generally, as businesses prosper financially, the greater the amount of taxes that both individuals and businesses pay to the government. Governments do not hoard tax revenue; they spend it. In so doing, they purchase even more goods and services that further contribute to the GDP. Therefore, there is a connection between the success of businesses in a region and that region's economy.

## Capitalism

Although businesses have been in operation since biblical times, there was no formal study of the relationship between businesses and economies until the publication of Adam Smith's book, *The Wealth of Nations*, in 1776. Smith was a Scottish philosopher who promoted individual economic freedom unhindered by government restriction and regulations (Figure 1.2). Smith argued that the government should not place any restrictions on commerce. He claimed that the buyers and sellers of goods and services, if left alone, would be able to determine:

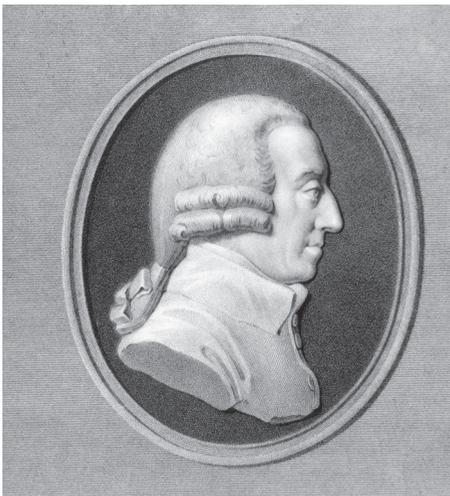
- which goods and services should be produced,
- the quantity of goods and services that needed to be produced, and
- the price at which goods and services should be bought and sold.

Smith's greatest insight was that the starting point of a nation's increased wealth is the division of labor. Division of labor would lead to specialization and specialization would lead to the desire to trade. Trade causes people to act in their own self-interest. Thus, individuals trade (or conduct business) because of their own self-interest, not because of the benefit that their goods and services can provide to their customers. Some would call this self-interest *greed*.

There is a scene in the 1987 movie *Wall Street* when the main character, Gordon Gekko, makes the statement that "*Greed is good.*" What he meant by this statement is that the desire to acquire personal wealth causes individuals to develop businesses that will create goods and services that otherwise might not exist. Both Adam Smith and Gordon Gekko would probably agree that if some individuals were not greedy, and acting in their own self-interest, many of the goods and services that we enjoy today would not exist.

Pure capitalism is a political philosophy that reasons that to maximize a nation's wealth there should be practically no government regulation on business, since regulation is the enemy of innovation. Self-interest fosters innovation, and innovation produces personal wealth and benefits to society in general.

**The free-market economy:** The economic system that is supported by capitalism is a *free-market economy*. A free-market economy is an economy that is not owned or controlled, either directly or indirectly, by any type of government power. Smith reasoned that the *invisible hand of the market* would create forces that



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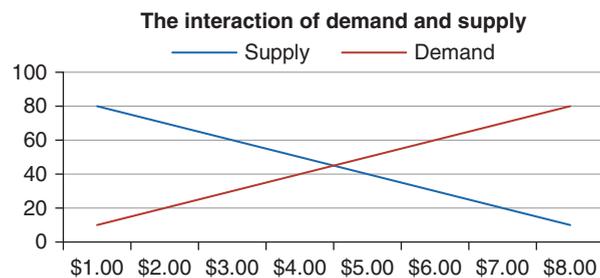
**Figure 1.2** Photograph of Adam Smith.  
Source: www.shutterstock.com

would result in a form of self-regulation. In a free-market economy, various buyers and sellers would interact and they would freely determine the price at which goods and services would be bought and sold, as well as the quantity of a particular good or service that would be demanded and supplied. A free market, in its purest form, would have absolutely no government ownership or regulation. In reality, no country has a pure free-market economy. The United States is the country which, most would agree, comes closest to a free-market economy.

**Demand and supply:** Smith (1776) maintained that the natural price of goods and services would be determined by buyers and sellers. If sellers believed that the market price for their product was too low, they would supply less. The lower supply would result in upward pressure on prices. If sellers believed that the price of their product was sufficiently high, they would supply more. The potential oversupply of the product would result in downward pressure on prices. Similarly, if customers perceived the price of a product to be too high, they would likely demand less of that product. However, if they perceived that a product was priced low, they would demand more of that product. When both buyers and sellers are in agreement on the price and quantity demanded and supplied, the market is said to be in equilibrium. The unregulated interaction of buyers and sellers, therefore, has the ability to determine both the equilibrium price and the equilibrium quantity, without any government intervention (Figure 1.3).

**Industrial Revolution:** Around the time of the publication of *The Wealth of Nations*, rapid industrial growth began in England and spread over the next 50 years to many other countries, including the United States. This period saw the development of steamships and railroads along with mechanization of agriculture and textile manufacturing, all of which had a massive influence on social, cultural, and economic conditions. During this time, child labor and unsafe working conditions were rampant in many factories. It was not uncommon for workers to work 50 hours per day, six days per week. The Industrial Revolution produced terrible working conditions, and some people opposed the negative consequences of capitalism on moral grounds.

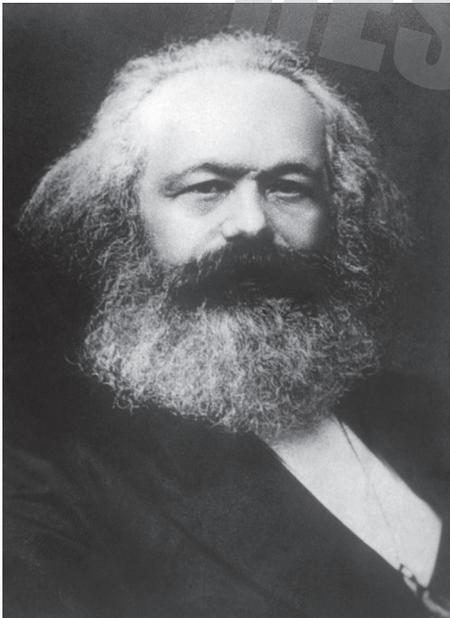
Price	Supply	Demand
\$1.00	80	10
\$2.00	70	20
\$3.00	60	30
\$4.00	50	40
\$5.00	40	50
\$6.00	30	60
\$7.00	20	70
\$8.00	10	80



**Figure 1.3** Demand and supply interaction which determines price.

## Communism

One of the major critics of capitalism was Karl Marx. Karl Marx was born in Prussia and was educated in Germany. Marx felt that as a result of capitalism, society was dividing into two conflicting groups—owners and laborers. One impact of Smith’s theory of free markets was that the few individuals who owned the factors of production at the time—primarily land—would be able to exploit the poor labor masses. The absence of government regulation meant that inhumane working conditions and price gouging prevailed, and there was no minimum wage. The absence of government intervention would mean that the strong would have supremacy over the weak. Marx stressed the labor market theory of value—that labor is the source of all value. Under the *labor market theory of value*, profits belonged to the laborers who produced the value, not the owners of the factors of production. However, under capitalism, in order for the owners of the factors of production to increase profits, they exploited the workers. Marx thought that the workers should be the ones to keep the value that they created. He also thought that, eventually, capitalism would lead to economic instability and violent class conflict would result. Marx believed that since capitalism would result in gigantic differences in two groups of society—owners of capital and workers—the central government should determine what needs to be produced, how much needs to be produced, and the price at which products and services should be sold (Figure 1.4). Since the free market could not be trusted to a fair distribution of value, it was the government’s responsibility to control commerce. The goal of communism is to create a classless society by removing the power of the owners of the factors of production, and creating *authoritarianism*. Communism believes that decisions should be made to benefit the collective population rather than to serve the greed of individuals. Communists believe in public government ownership of all factors of production.



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**Figure 1.4** Photograph of Karl Marx.  
Source: www.shutterstock.com

**The Command Economy:** Marx influenced many of his followers about the potential social evils of capitalism. The economic system that the followers of Marx—known as Marxists—preferred is a centrally planned economy. In a centrally planned economy, the central government makes decisions about what needs to be produced, how much needs to be produced, and the price at which products and services should be sold. In a command economy, consumers do not have choices among brands of products.

As an example, the government will determine the type of bread that will be produced; therefore, there will only be one brand of bread. The government will produce a type of bread that they believe will be in the best interest of all residents. As a result, along the bread aisle of a grocery store in a command economy, there will only be one brand of bread—the bread produced by the government. Since all factors of production are owned by the government, there is no private company to produce a competing brand of bread. Since the government has no competition in bread production, there is no incentive to satisfy the differing desires of the residents.

In a command economy, the government will establish the price at which bread will be sold. Every loaf of bread in the entire country will be sold at exactly the same price—the price established by the government. Since there is no price competition, there is no incentive on the part of the government to try to reduce the price of bread. Since there is no incentive to reduce the price of bread, there is also no incentive to try to reduce, or eliminate, inefficiencies in bread production. Therefore, the lack of competition in command economies tends to result in inefficiencies and higher prices. Command economies may result in fair treatment of all people, but the lack of competition often produces inefficiencies that may result in residents paying higher prices for inferior goods and services. But, at least in theory, everyone is being treated equally. Today, North Korea is the country that is the best example of a command economy.

## Problems with Free-Market and Command Economies

While both capitalism and communism result in economic systems with unique advantages, they also result in complications. Free-market economies will tend to produce innovation, resulting in indulgent products and services because individuals who own private companies have a financial motivation to produce new and innovative products efficiently, and at competitive prices. Individuals who win at the product creation and distribution game are rewarded by becoming wealthy. Unfortunately, in a command economy, while a few will become very wealthy, the lack of government intervention will mean that many more will remain poor and may even be taken advantage of by the wealthy.

Under a pure command economy, there is no individual incentive to even try to develop a new product since everything is owned collectively by the government. What would be the incentive to invest the time and effort to develop a new product if you could not profit from it? Although some may see greed as evil, the absence of greed results in indifference and lack of motivation. So, under a purely command economy, there is almost no creativity and very low productivity.

It is clear that both systems in their purest forms create problems. Capitalism results in the unfair distribution of wealth, while communism results in everyone being equally poor. However, both systems also have some good features. A system that could incorporate the best features of capitalism (creativity and efficiency) and at the same time incorporate the best features of communism (social fairness and prevention of abuse) would be ideal (Table 1.2). Socialism is the political system that attempts to incorporate the best of both capitalism and communism.

**Table 1.2** Political and Economic Systems, with Examples

Political System	Economic System	Examples
Capitalism	Free-market economy	United States
Communism	Command economy	North Korea
Socialism	Mixed economy	United Kingdom

## Socialism

Socialism is a political system that encourages the private ownership of most factors of production, while realizing that there are a few essential industries that are so vital to the welfare

of the nation that such industries should be publicly owned. Socialists criticize capitalism for concentrating wealth and power within a small segment of society. Socialists criticize communists for being unable to create and sustain economic growth. Although socialism encourages individual wealth creation, the system imposes some regulation so a few individuals do not become wealthy by abusing others. Socialism was the most dominant global political movement of the 20th century.

In a socialist country, individuals are allowed to own private property, including the factors of production. However, regulation intended to protect the interest of society as a whole are imposed. Regulation take the form of required government permits and licensing; required enhanced working condition and compensation for employees; and some restrictions on competition, trade, and the environment. Some view these restrictions as oppressive to business, while others view restrictions as providing a level playing field on which businesses are allowed to compete with each other within the rules of the game.

Socialist countries believe there are some industries that are so vital to the nation that private ownership of such industries is either not permitted or very heavily restricted. Industries such as utilities, transportation, mining, and emergency services often fall into this category. Utilities such as water, electricity, and gas supply are often owned by some government entity such as a city, county, or state. With regard to transportation, many socialist counties own their national airline. Examples include Air Canada and British Airways. Ground transportation such as bus and rail services are also often nationalized—owned by the government. Oil, gas, and mineral extraction operations are often owned by the national government or are contracted out to private companies under strict government licensing agreements.

Most countries, including the United States, believe that public services such as garbage collection and disposal, police protection and firefighting services are so fundamental to a fully functioning society that these tasks should not be privatized, but rather should be functions of city, county, or state governments. In the few instances when such services are allowed to be privatized, private companies are allowed to operate only under strict government licensing agreements. Canada, France, and Germany are examples of socialist countries.

## The Mixed Economy

The economic system that operates in a socialist political system is known as a mixed economy. It is mixed because it has elements of both a free-market economy and a command economy. There are varying degrees of mixed economies that exist in the world today. Some mixed economies lean very heavily toward a command economy model, while still allowing private ownership. Other mixed economies lean very heavily toward the free-economy model, while providing limiting restriction and government oversight. Thus, there is a very wide spectrum of economies that are considered to be mixed economies.

## The United States

A reasonable argument can be made that although the United States is the best example of a free-market economy, there are a few command economy features that coexist in the economy. For example, most residents of the United States receive their water supply from some type of local government, rather than from a private company. Garbage disposal, police, and fire protection are also more likely provided by a local government entity than from private companies.

The federal government has many business regulations in place to protect employees' rights and the environment. The federal government also holds businesses accountable for the amount of control they have in society. Some government regulations are more extensive than others because of their potential impact on employees and consumers. Below is a list of federal agencies:

- U.S. Department of Agriculture
- U.S. Department of Commerce
- U.S. Department of Education
- U.S. Department of Energy
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- U.S. Department of Housing and Urban Development
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Department of Transportation
- U.S. Department of the Treasury

An argument can be made that every one of the federal agencies listed has issued regulations that restrict how businesses can operate within the United States. While some business people might view these regulations as obstructive to free enterprise, others will view the regulations as attempts to protect the American public from corporate greed and abuse.

### North Carolina

In addition to federal agencies that regulate business nationwide, each state has its own set of regulations that businesses must abide by. In the state of North Carolina, the four primary agencies that regulate business operations include

- The NC Department of the Secretary of State
- The NC Department of Commerce
- The NC Department of Labor
- The NC Department of Revenue

**The NC Department of the Secretary of State** is responsible for the examination, custody, and maintenance of the legal documents filed by more than 400,000 business entities within the state. The duty of the Secretary of State (SOS) is to ensure uniform compliance with the statutes governing the creation of these entities, record the information required to be kept as a public record, and provide that information to the public.

**The NC Department of Commerce** is responsible for recruiting companies to the state, helping existing North Carolina companies expand, encouraging business startups, enabling companies to export, and marketing North Carolina as a business destination. The department is the state's lead agency for economic, community, and workforce development. Taking a comprehensive approach to economic development, the department's work reaches many areas. The department helps people find jobs and employers find and retain a qualified workforce. The department administers the state's employment security system, supporting workers

during career transitions. The NC Department of Commerce provides local communities with grants and planning services to spur infrastructure development and economic growth, and administers the state's economic incentive programs.

**The NC Department of Labor** is charged with promoting the "health, safety and general well-being" of more than four million workers in North Carolina. The department serves the needs of the workplace through a variety of programs aimed at making the employees of North Carolina safe. Through its various bureaus, the NC Department of Labor touches nearly every North Carolinian's life, from boiler safety and elevator safety to workplace safety and health.

**The NC Department of Revenue** was created by the North Carolina General Assembly in 1921, making it one of the first in the United States. The Department of Revenue (DOR) was created to administer, enforce, and collect individual and business income taxes. North Carolina businesses collect sales taxes that will need to be sent to the DOR on a regular basis. In addition, businesses located in North Carolina are required to withhold NC income taxes from their employees' pay that will also need to be remitted to the DOR on a periodic basis. Furthermore, businesses that operate within the state of North Carolina are required to submit periodic income tax returns, reporting their revenues derived and expenses incurred in the state.

## CHAPTER ASSIGNMENTS

1. Using the Internet, go to the NC Secretary of State website located at <http://www.secretary.state.nc.us/>. Select any two of the divisions within the Secretary of State's office and write a summary of the purpose and functions of each of the two divisions. Each summary should consist of at least 100 words.
2. Using the Internet, go to the NC Department of Revenue's website located at <http://www.dornc.com/>. Find the section of the website that gives the history of the department. Summarize the history of the department in no fewer than 75 words.
3. Using the Internet, go to the NC Department of Commerce's website located at <http://www.nccommerce.com/>. Find the monthly unemployment rate in your county over the previous 12 months.
4. Using the Internet, go to the NC Department of Labor's website located at <http://www.nclabor.com/index.htm>. Locate and report on the most recent *Fatal occupational injuries in North Carolina*.