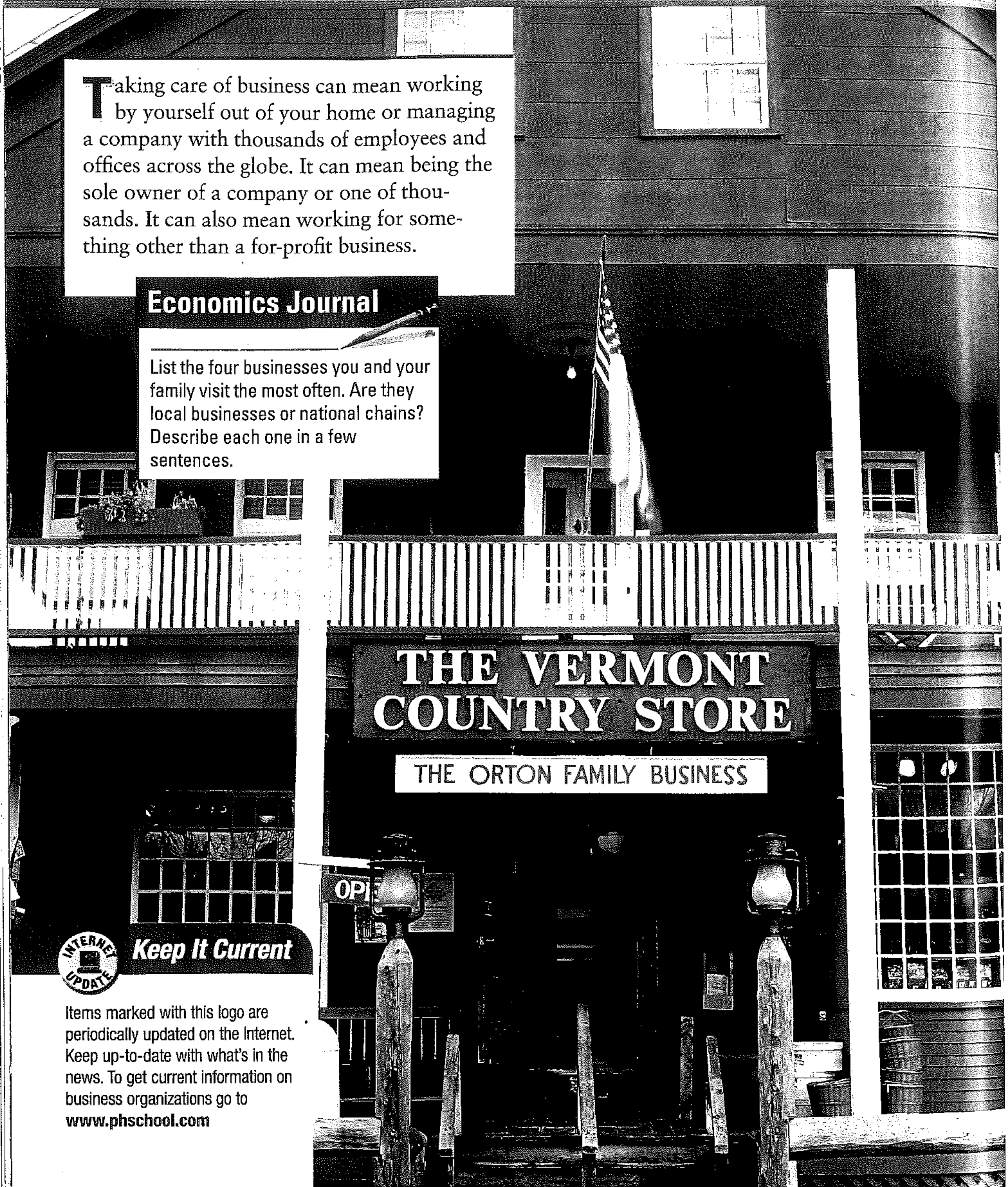
Chapter 8 Business Organizations

Taking care of business can mean working by yourself out of your home or managing a company with thousands of employees and offices across the globe. It can mean being the sole owner of a company or one of thousands. It can also mean working for something other than a for-profit business.

Economics Journal

List the four businesses you and your family visit the most often. Are they local businesses or national chains? Describe each one in a few sentences.



Keep It Current

Items marked with this logo are periodically updated on the Internet. Keep up-to-date with what's in the news. To get current information on business organizations go to **www.phschool.com**

Section 1

Sole Proprietorships

Preview

Objectives

After studying this section you will be able to:

1. **Explain** the characteristics of sole proprietorships.
2. **Analyze** the advantages of a sole proprietorship.
3. **Analyze** the disadvantages of a sole proprietorship.

Section Focus

A business is an economic institution that seeks a profit by allocating resources to satisfy customers. Sole proprietorships are the most common form of business in the United States. They are easy to establish and offer owners both the benefits and drawbacks that come with full control of a business.

Key Terms

business organization
sole proprietorship
business license
zoning law
liability
fringe benefit

Entrepreneurs must make many decisions as they start up new businesses. One of the first decisions they face is what form of business organization best serves their interests. A **business organization** is an establishment formed to carry on commercial enterprise. In other words, a business organization is a company, or firm. Sole proprietorships are the most common forms of business organization.

The Role of Sole Proprietorships

A **sole proprietorship** is a business owned and managed by a single individual. That person earns all of the firm's profits and is responsible for all of the firm's debts. This type of firm is by far the most popular in the United States. According to the Internal Revenue Service, about 75 percent of all businesses are sole proprietorships. Most sole proprietorships are small, however. All together they generate only about 6 percent of all United States sales.

Many types of businesses can flourish as sole proprietorships. Look around your town. Chances are good that your local bakery, your barber shop or hair salon, your bike-repair shop, and the corner store are all sole proprietorships.

Advantages of Sole Proprietorships

While you need to do more than just hang out a sign to start your own business, a sole proprietorship is simple to establish. It also offers the owner numerous advantages.

business organization *an establishment formed to carry on commercial enterprise*

sole proprietorship *a business owned and managed by a single individual*

◀ **Personal pride motivates many sole proprietors.**

It takes a certain type of personality to start up a business.

Entrepreneurs **Describe some times when you exhibited entrepreneurial spirit.**

Figure 8.1 The Entrepreneurial Spirit

Entrepreneurs . . .

- ★ Seek out responsibility
- ★ Are willing to take risks
- ★ Believe in themselves
- ★ Desire to reach their full potentials
- ★ Have high energy levels
- ★ Are upbeat and optimistic
- ★ Look toward the future rather than the past
- ★ Value achievement over money
- ★ Maintain flexibility as they face new challenges
- ★ Are strongly committed to their goals

Ease of Start-Up

business license *authorization to start a business issued by the local government*

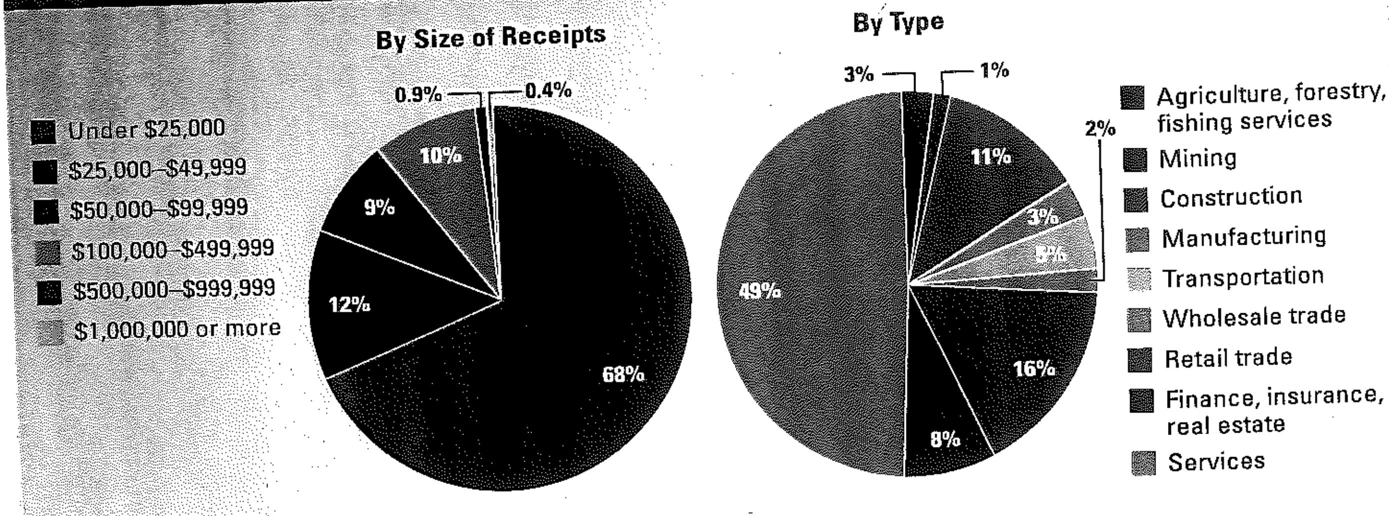
Easy start-up is one of the main advantages of the sole proprietorship. With just a small amount of paperwork and legal expense, just about anyone can start a sole proprietorship.

To start a new business, a sole proprietor must meet a small number of government requirements, which can vary from city to city and state to state. Typically, sole proprietors must meet the following minimum requirements:

1. *Authorization* Sole proprietors must obtain a **business license**, which is an authorization from the local government. Certain professionals, such as doctors and day-care providers, may also be required to obtain a special license from the state.
2. *Site permit* If not operating out of the home, a sole proprietor must obtain a certificate of occupancy to use another building for business.
3. *Name* If not using his or her own name as the name of the business, a sole proprietor must register a business name.

This paperwork often takes only a day or two to complete. The most difficult part of starting a new business is coming up with a good idea!

Figure 8.2 Characteristics of Proprietorships



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States*, 2000

Most sole proprietorships take in relatively small amounts of money, or receipts. Many proprietors run their businesses part-time.

Specialization **What percentage of sole proprietorships is engaged in retail trade? Why might more sole proprietors be engaged in services rather than manufacturing?**

Relatively Few Regulations

A proprietorship is the least-regulated form of business organization. Even the smallest business, however, is subject to some regulation, especially industry-specific regulations. For example, a gourmet soft pretzel stand would be subject to health codes, and a furniture refinishing business would be subject to codes regarding dangerous chemicals.

Sole proprietorships may also be subject to local **zoning laws.** Cities and towns often designate separate areas, or zones, for residential use and for business. Zoning laws may prohibit sole proprietors from operating businesses out of their homes.

Otherwise, these small businesses face few legal requirements. Because they require little legal paperwork, sole proprietorships are usually the least expensive form of ownership to establish.

Sole Receiver of Profit

A major advantage of the sole proprietorship is that the owner gets to keep all profits after paying income taxes. Potential profits motivate many people to start their own businesses. If the business succeeds, the owner does not have to share the success with anyone else.

Full Control

Another advantage of sole proprietorship is that sole proprietors can run their businesses as they wish. This means that they can respond quickly to changes in the marketplace. Such a degree of freedom appeals to entrepreneurs. Fast, flexible decision making allows sole proprietorships to take full advantage of sudden opportunities.

Easy to Discontinue

Finally, if sole proprietors decide to stop operations and do something else for a living, they can do so easily. They must, of course, pay all debts and other obligations like taxes, but they do not have to meet any other legal obligations to stop doing business.

▲ **What are the benefits of running a business from home?**

Disadvantages of Sole Proprietorships

As with everything else, there are trade-offs with sole proprietorships. The independence of a sole proprietorship comes with a high degree of responsibility.

Unlimited Personal Liability

The biggest disadvantage of sole proprietorship is unlimited personal liability. **Liability** is the legally bound obligation to pay debts. Sole proprietors are fully and personally responsible for all their business debts. If the business fails, the owner may have to sell personal property to cover any outstanding obligations.

For example, let's say you took out a loan to buy a ride-on lawn mower as part of your landscaping business. Even if you don't make enough money to stay in business, you must still repay the loan for the lawn mower. Business debts can ruin a sole proprietor's personal finances.

Limited Access to Resources

If your landscaping business takes off and grows quickly, you might need to expand

zoning law *law in a city or town that designates separate areas for residency and for business*

liability *the legally bound obligation to pay debts*

THE WALL STREET JOURNAL.
CLASSROOM EDITION

***In the News** As this excerpt from a* Wall Street Journal Classroom Edition *article shows, many minority leaders recently have been urging young people to consider life as an entrepreneur.*

"'Our kids see athletes and entertainers as their only role models,' says George Herrera, president of the U.S. Hispanic Chamber of Commerce. 'We have to show them that there are opportunities in starting a business.' The group is forming a junior Hispanic chamber that it hopes will fuel interest in entrepreneurship for Hispanic teens."

your business by buying more equipment. But as a sole proprietor, you may have to expand by paying for the equipment out of your own pocket. This is because banks are sometimes unwilling to offer financing in the early days of a business. Many small business owners use all of their available savings and other personal resources to start up their businesses. This makes it difficult or impossible for them to expand quickly.

Physical capital may not be the only factor resource in short supply. Human capital may be lacking, too. A sole proprietor, no matter how ambitious, may lack some of the skills necessary to run a business successfully. All individuals have strengths and weaknesses. Some aspects of your business may suffer. For example, you may be great at sales, but not at bookkeeping and accounting. You may love working outdoors landscaping, but hate to call on people to drum up business.

fringe benefit *payment other than wages or salaries*

Finally, as a sole proprietor, you may have to turn down work because you simply don't have enough hours in the day or enough workers to keep up with demand. A small business often presents its owner with too many demands, and that can be exhausting both personally and financially.

Lack of Permanence

A sole proprietorship has a limited life. If a sole proprietor dies or closes shop due to retirement, illness, loss of interest in the business, or for any other reason, the business simply ceases to exist.

Sole proprietorships often have trouble finding and keeping good employees. Small businesses generally cannot offer the security and advancement opportunities that many employees look for in a job. In addition, many sole proprietorships are able to offer employees little in the way of fringe benefits. **Fringe benefits** are payments to employees other than wages or salaries, such as paid vacation, retirement pay, and health insurance. Lack of experienced employees can hurt a business. Once again, the flip side of total control is total responsibility: a sole proprietor cannot count on anyone else to maintain the business.

Section 1 Assessment

Key Terms and Main Ideas

1. What is a **business organization?**
2. What is a **sole proprietorship?**
3. What role do **business licenses** and **zoning laws** play in sole proprietorships?
4. What kinds of **liabilities** are sole proprietors subject to?
5. Why do you think many sole proprietorships are able to offer few **fringe benefits** to workers?

Applying Economic Concepts

6. *Using the Databank* Examine the graph "Fastest-Growing Occupations" on page 537. Which of these occupations do you think could operate successfully as sole proprietorships? Explain your reasoning.
7. *Try This* Refer to Figure 8.1, "The Entrepreneurial Spirit," on page 186. How many of these traits do you have? Would you like to start your own business someday? Why or why not?

Take It to the NET

Suppose that you will be opening a business of your own soon. First, decide what the business will be. Next, write down three questions you have about starting your own business, such as "Where will I get the money to start up my business?" Answer your questions using Internet resources. Use the links provided in the Social Studies area at the following Web site for help in completing this activity. **www.phschool.com**

Section 2

Partnerships

Preview

Objectives

After studying this section you will be able to:

1. **Compare and contrast** the different types of partnerships.
2. **Analyze** the advantages of partnerships.
3. **Analyze** the disadvantages of partnerships.

Section Focus

Partnerships let individuals pool their resources and share responsibility for the forming and running of a business.

Key Terms

partnership
general partnership
limited partnership
limited liability partnership (LLP)
articles of partnership
Uniform Partnership Act (UPA)
assets

partnership *a business organization owned by two or more persons who agree on a specific division of responsibilities and profits*

general partnership *partnership in which partners share equally in both responsibility and liability*

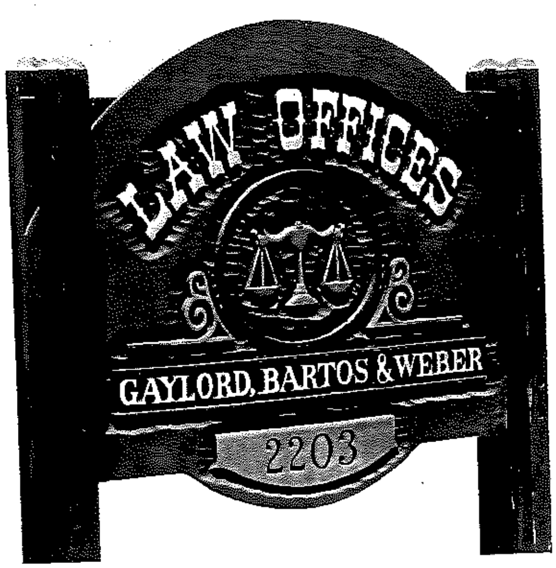
limited partnership *partnership in which only one partner is required to be a general partner*

limited liability partnership (LLP) *partnership in which all partners are limited partners*

A **partnership** is a business organization owned by two or more persons who agree on a specific division of responsibilities and profits. In the United States, partnerships account for about 7 percent of all businesses. They generate about 5 percent of all sales and about 10 percent of all income.

Types of Partnerships

Partnerships fall into three categories: general partnerships, limited partnerships, and limited liability partnerships. Each divides responsibility and liability differently.



Sometimes three ▶ heads are better than one.

General Partnership

The most common type of partnership is the **general partnership.** Partners in a general partnership share equally in both responsibility and liability. Many of the same kinds of businesses that operate as sole proprietorships could operate as general partnerships. Doctors, lawyers, accountants, and other professionals often form partnerships with colleagues. Small retail stores, farms, construction companies, and family businesses often form partnerships as well.

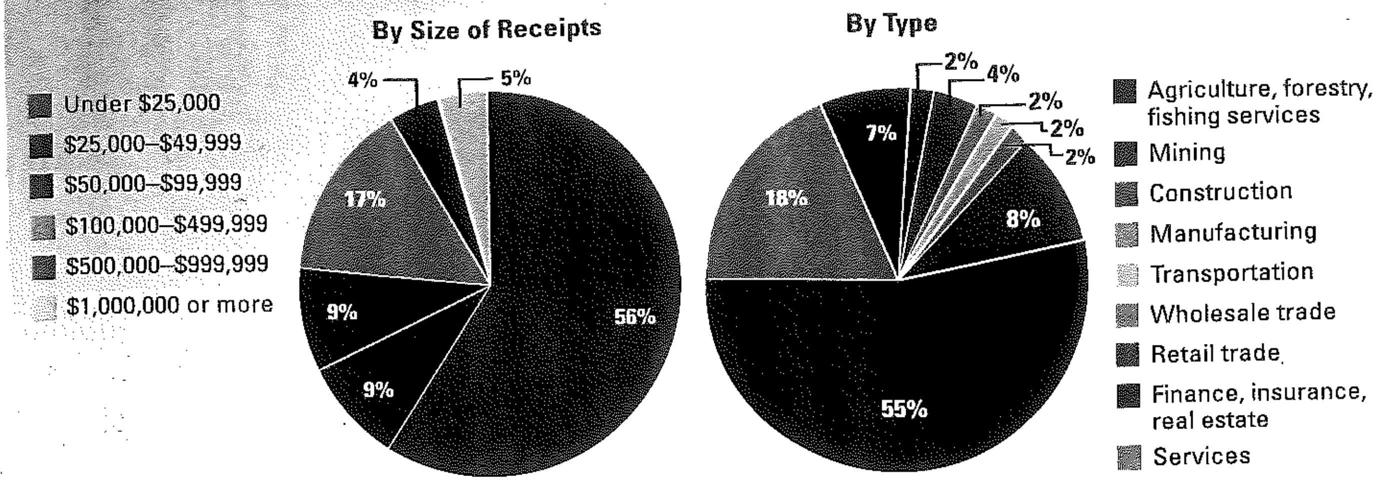
Limited Partnership

In a **limited partnership,** only one partner is required to be a general partner. That is, only one partner has unlimited personal liability for the firm's actions. The remaining partner or partners contribute only money. They do not actively manage the business. Limited partners can lose only the amount of their initial investment. A limited partnership must have at least one general partner, but may have any number of limited partners. The main advantage of being a general partner is in having control of the business. The main drawback, of course, is the extent of liability.

Limited Liability Partnerships

The **limited liability partnership (LLP)** is a newer type of partnership recognized by

Figure 8.3 Characteristics of Partnerships



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States*, 2000

Building Key Concepts

Partnerships can range in size from a pair of house painters to an accounting firm with thousands of partners.

Specialization **Using the information in these graphs, describe partnerships in terms of industry and income.**

many states. In this type of partnership, all partners are limited partners. An LLP functions like a general partnership, except that all partners are limited from personal liability in certain situations, such as another partner's mistakes. Not all types of businesses are allowed to register as limited liability partnerships. Most states allow professionals such as attorneys, physicians, dentists, and accountants to register as LLPs.

Advantages of Partnerships

Partnerships are easy to establish and are subject to few government regulations. They provide entrepreneurs with a number of advantages.

Ease of Start-Up

Like proprietorships, partnerships are easy and inexpensive to establish. The law does not require a written partnership agreement. Most small business experts, however, advise partners to work with an attorney to develop **articles of partnership,** or a partnership agreement. This legal document spells out each partner's rights and responsibilities. It outlines how partners will share profits or losses. Partnership agreements may also address other details, such as the ways new partners can join the firm, duration of the partnership, and tax responsibilities.

If partners do not establish their own articles of partnership, they will fall under the rules of the **Uniform Partnership Act (UPA).** The Uniform Partnership Act is a uniform state law adopted by most states to establish rules for partnerships. The UPA requires common ownership interests, profit and loss sharing, and shared management responsibilities.

Like sole proprietorships, partnerships are subject to little government regulation. The government does not dictate how partnerships conduct business. Partners can distribute profits as they wish, as long as they abide by the partnership agreement or by the UPA.

articles of partnership *a partnership agreement*

Uniform Partnership Act (UPA) *act ordering common ownership interests, profit and loss sharing, and shared management responsibilities in a partnership*

THE WALL STREET JOURNAL.
CLASSROOM EDITION

In the News As this excerpt from a Wall Street Journal Classroom Edition article shows, a nonprofit program called Mother and Daughter Entrepreneurs in Teams teaches mother and daughter partners how to start a business. Participants earn money to help pay the daughter's college tuition.

"At the Gibson home, the burden of saving for a 13-year-old daughter's college education begins this year. But the funds won't come from the salaries of Megan's parents.

Mary Gibson, the girl's mother, plans to pay for tuition with profits from the business she and her daughter just founded. . . . During their venture's first full year of operations, the Gibsons forecast net income of $4,700."

Shared Decision Making and Specialization

In a sole proprietorship, the individual owner has the sole burden of making all the business decisions. In a partnership, the responsibility for the business may be shared. A sole proprietorship requires the owner to wear many hats, some of which might not fit very well. In a successful partnership, however, each partner brings different strengths and skills to the business.

Larger Pool of Capital

Each partner's **assets,** or money and other valuables, improve the firm's ability to borrow funds for operations or expansion. Partnership agreements can also allow firms to add limited partners to raise funds.

assets *money and other valuables belonging to an individual or business*

Partnerships offer more advantages to employees, enabling them to attract and keep talented employees more easily than proprietorships can. Graduates from top accounting schools, for example, often seek jobs with large and prestigious accounting LLPs, hoping to become partners themselves someday.

Taxation

Partnerships, like sole proprietorships, are not subject to any special taxes. Partners pay taxes on their share of the income that the partnership generates. The business itself, however, does not have to pay taxes.

Disadvantages of Partnerships

Partnerships also present some disadvantages. Many of the disadvantages of sole proprietorships are present in partnerships. Limited liability partnerships have fewer disadvantages than partnerships with general partners. All partnerships, however, have the potential for conflict.

Unlimited Liability

Unless the partnership is an LLP, at least one partner has unlimited liability. As in a sole proprietorship, any general partner could lose everything, including personal property, in paying the firm's debts. Limited partners do not face the same threat. They can lose only their investment.

In a partnership, each general partner is bound by the acts of all other general partners. If one partner's actions cause the firm losses, then all of the general partners suffer. If one doctor in a partnership is

Like sole proprietors, partners must maintain their entrepreneurial spirit to stay in business.

▲ These partners must find positive ways to deal with conflict if they want to keep their business running smoothly.

sued for malpractice, all of the doctors in the partnership stand to lose. General partners do not enjoy absolute control over the firm's actions like sole proprietors do. The risk from other people's actions means that people must choose their business partners carefully.

Potential for Conflict

As in any close relationship, partnerships have the potential for conflict. Partnership agreements address technical aspects of the business, such as profit and loss. Many important considerations exist outside these legal guidelines, however. Partners need to ensure that they agree about work habits, goals, management styles, ethics, and general business philosophies. Still, friction between partners often arises and can be difficult to resolve. Many partnerships dissolve because of interpersonal conflicts. Partners must learn to communicate openly and find ways to resolve conflicts.

Section 2 Assessment

Key Terms and Main Ideas

1. Explain the characteristics of **partnerships.**
2. How do **general partnerships, limited partnerships,** and **limited liability partnerships** differ?
3. What issues are addressed in **articles of partnership?**
4. What is the purpose of the **Uniform Partnership Act?**

Applying Economic Concepts

5. ***Critical Thinking*** Why might accountants and physicians find limited liability partnerships attractive?
6. ***Critical Thinking*** Do you think the advantages of partnerships outweigh the disadvantages? Why or why not?
7. ***Problem Solving*** You and your general partners are operating under the Uniform Partnership Act, not your own articles of partnership. Now you cannot agree who should be responsible for which duties. How will you resolve your conflict?
8. ***Try This*** With a partner or two, draw up articles of partnership for a fictional business. Decide which type of partnership best suits your business and your personal preferences and skills.

Take It to the NET Choose a classmate and suppose that the two of you have just decided to form a new partnership for a business venture. Find out what's required in your state to start your new business. Use the links provided in the Social Studies area at the following Web site for help in completing this activity. **www.phschool.com**

Section 3

Corporations, Mergers, and Multinationals

Preview

Objectives

After studying this section you will be able to:

1. **Explain** the characteristics of corporations.
2. **Analyze** the advantages of incorporation.
3. **Analyze** the disadvantages of incorporation.
4. **Compare and contrast** corporate combinations.
5. **Describe** the role of multinational corporations.

Section Focus

Corporations are complex business organizations that can be combined to form even larger businesses. Some corporate enterprises span the globe.

Key Terms

corporation
stock
closely held corporation
publicly held corporation
bond
certificate of incorporation
dividend
horizontal merger
vertical merger
conglomerate
multinational corporation (MNC)

Businesses often rely on investment to expand operations. One way for a business to increase investment is to form a corporation. A corporation can grow even larger by combining with other corporations. Some corporations are so large that they do business all over the world.

Corporations

The most complex form of business organization is the corporation. A **corporation** is a legal entity, or being, owned by individual stockholders, each of whom faces limited liability for the firm's debts. Stockholders own **stock,** a certificate of ownership in a corporation. In other words, if you own stock in a corporation, you are a part-owner of that corporation. If a corporation issues 1,000 shares of stock, and you purchase 1 share, you own 1/1000th of the company.

Corporations differ from sole proprietorships, which have no identity beyond that of the owners. A corporation is defined as an "entity" because it has a legal identity separate from those of its owners. Legally, it is regarded much like an individual. A

corporation *a legal entity owned by individual stockholders*

stock *a certificate of ownership in a corporation*

Many corporations make their headquarters in large cities. ▼

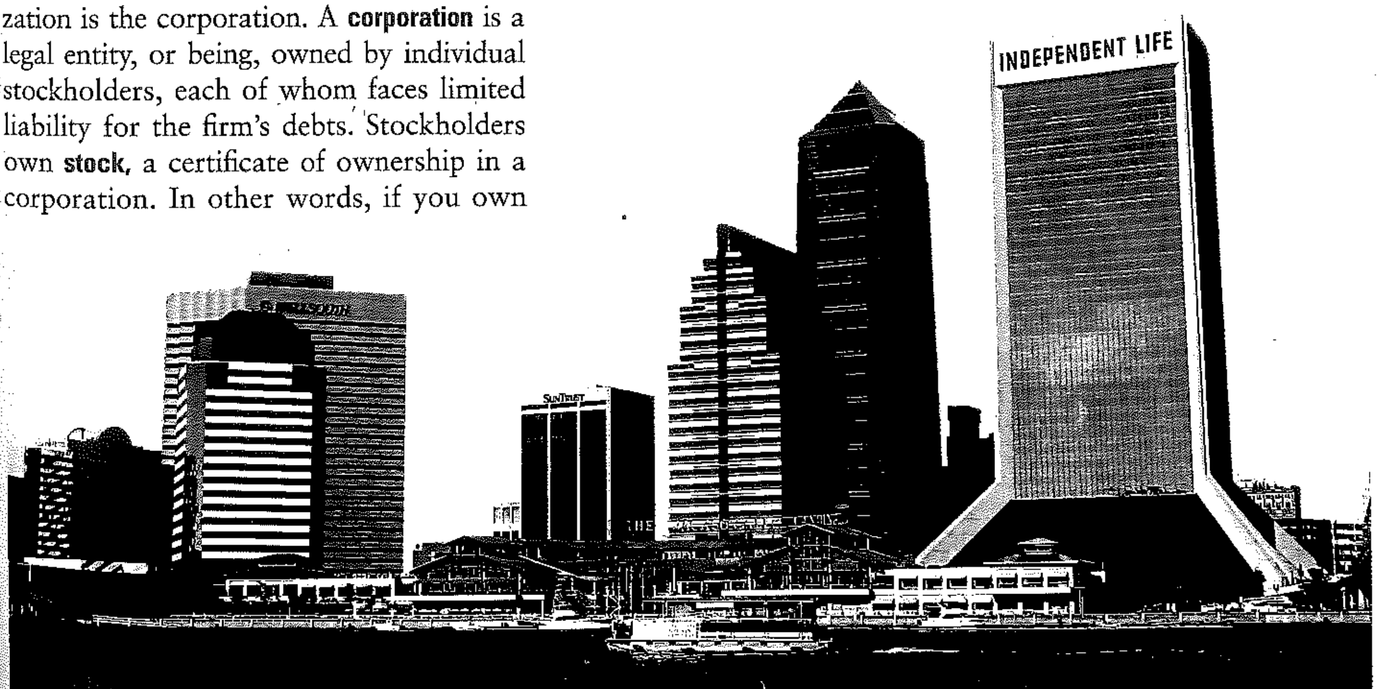
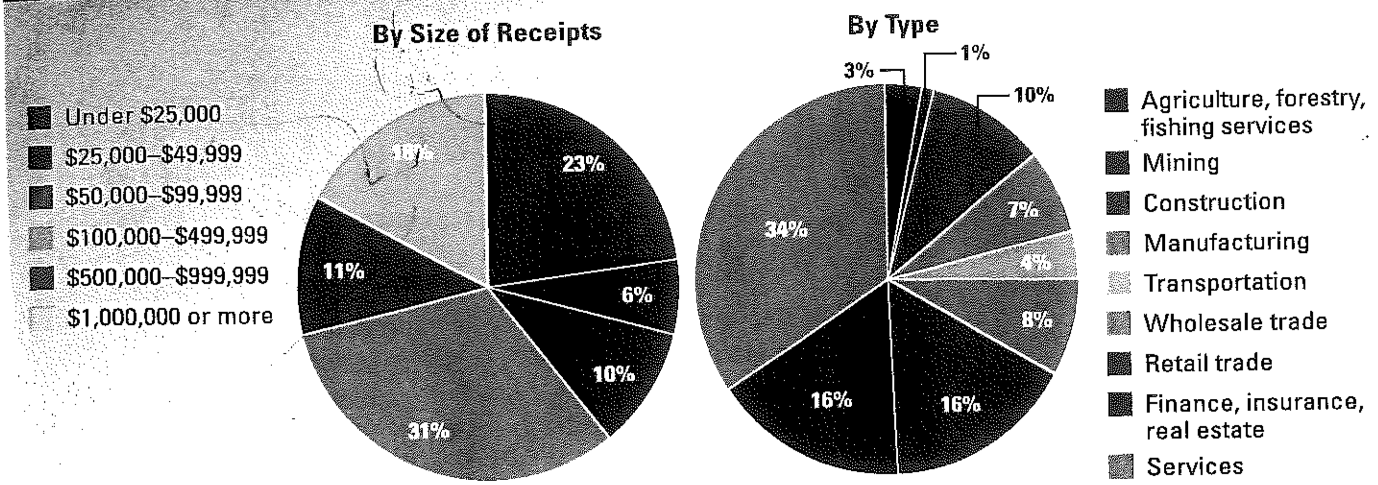


Figure 8.4 **Characteristics of Corporations**



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: *Statistical Abstract of the United States*, 2000

Notice that over 60 percent of corporations are engaged in services, manufacturing, wholesale trade, and retail trade.
Incentives **What incentives do businesses in these particular industries have to form corporations?**

closely held corporation *corporation that issues stock to only a few people, often family members*

publicly held corporation *corporation that sells stock on the open market*

corporation pays taxes, may engage in business, make contracts, sue other parties, and get sued by others.

In the United States, corporations account for about 20 percent of all businesses, yet sell about 90 percent of all products sold in the nation. They generate about 70 percent of the net income earned in the nation. Because of the advantages of corporations, most large business firms do incorporate. Supermarkets, high-tech companies, and machinery manufacturers are just some of the types of firms that usually form corporations. Corporations' profits are about ten percent of their income.

Types of Corporations

Some corporations issue stock to only a few people, often family members. These stockholders rarely trade their stock, but pass it on within families. Such corporations are called **closely held corporations.** They are also known as privately held corporations.

A **publicly held corporation,** on the other hand, has many shareholders who can buy or sell stock on the open market. Stocks are bought and sold at financial markets called stock exchanges, such as the New York Stock Exchange. You will read about these financial markets in Chapter 11.

Corporate Structure

While the exact organization varies from firm to firm, all corporations have the same basic structure. Corporation owners—the stockholders—elect a board of directors. The board of directors makes all the major decisions of the corporation. It appoints corporate officers, who run the corporation and oversee production. Corporate officers, in turn, hire managers and employees, who work in various departments like finance, sales, research, marketing, and production.

Advantages of Incorporation

Incorporation, or forming a corporation, offers advantages to both the individual owners, or stockholders, and to the corporation itself. These include

- limited liability for owners
- transferable ownership
- ability to attract capital
- long life

Advantages for Stockholders

The primary reason that entrepreneurs choose to incorporate, or form a corporation, is to gain the benefit of limited liability. Individual investors do not carry responsibility for the corporation's actions. They can lose only the amount of money they have invested in the business.

Corporations usually also provide stockholders with more flexibility than other ownership forms. Shares of stock are transferable, which means that stockholders can sell their stocks to others and get money in return.

Advantages for the Corporation

The corporate structure also presents advantages for the firm itself. Corporations have more potential for growth than other business forms. By selling shares on the stock market, corporations can raise money to purchase capital. A corporation can offer as many shares of stock as its corporate charter allows. As long as investors have confidence in the firm's success, companies should be able to sell stock fairly easily.

Corporations can also raise money by borrowing it. They do this by selling bonds. A **bond** is a formal contract to repay borrowed money with interest at fixed intervals.

Because ownership is separate from the running of the firm, corporation owners—that is, stockholders—do not need any special managerial skills. Instead, the corporation can hire various experts—the best financial analysts, the best engineers, and so forth—to create and market the best services or goods possible.

Corporations also have the advantage of long life. Unlike a sole proprietorship, the company does not end with the death of an owner. Because stock is transferable, that is, it can be bought and sold, corporations are able to exist longer than simple proprietorships. Unless it has stated in advance a specific termination date, the corporation can continue doing business indefinitely.

Disadvantages of Incorporation

Corporations are not without their disadvantages. These include

- expense and difficulty of start-up
- double taxation
- potential loss of control by the founders
- more legal requirements and regulations

Difficulty and Expense of Start-Up

Corporate charters can be difficult, expensive, and time consuming to establish. Though most states allow people to form corporations without legal help, few experts would recommend this cheaper shortcut. Applications are complex and confusing.

Firms that wish to incorporate must first file for a state license known as a **certificate of incorporation,** or corporate charter. The application includes crucial information such as

- the corporate name
- statement of purpose
- length of time that the business will run (usually "for perpetuity," or without limit)
- founders' names and addresses
- headquarters' business address
- method of fund-raising
- the rules for the corporation's management

Once state officials review and approve the application, they grant a corporate charter. Then the corporation may organize itself to produce and sell a good or service.

Double Taxation

The law considers corporations legal entities separate from their owners. Corporations, therefore, must pay taxes on their income.

bond *a formal contract to repay borrowed money with interest at fixed intervals*

certificate of incorporation *license to form a corporation issued by state government*

dividend *the portion of corporate profits paid out to stockholders*

Profit is a form of income. When stockholders receive income from the corporation in the form of **dividends**—the portion of corporate profits paid out to stockholders—the stockholders must pay personal income tax on those dividends. This double taxation keeps many firms from incorporating.

Stockholders may face an additional tax if they sell their shares. When stockholders sell their shares, they must pay a special tax, called a capital gains tax, if they have made a profit.

Loss of Control

Unlike the owner of a sole proprietorship, the original owners of a corporation often lose control of the company. Managers and boards of directors, not owners, manage corporations. These professional managers do not always act in the owners' best interests. They might be more interested in protecting their own jobs or salaries today than in making difficult decisions that would benefit the firm tomorrow.

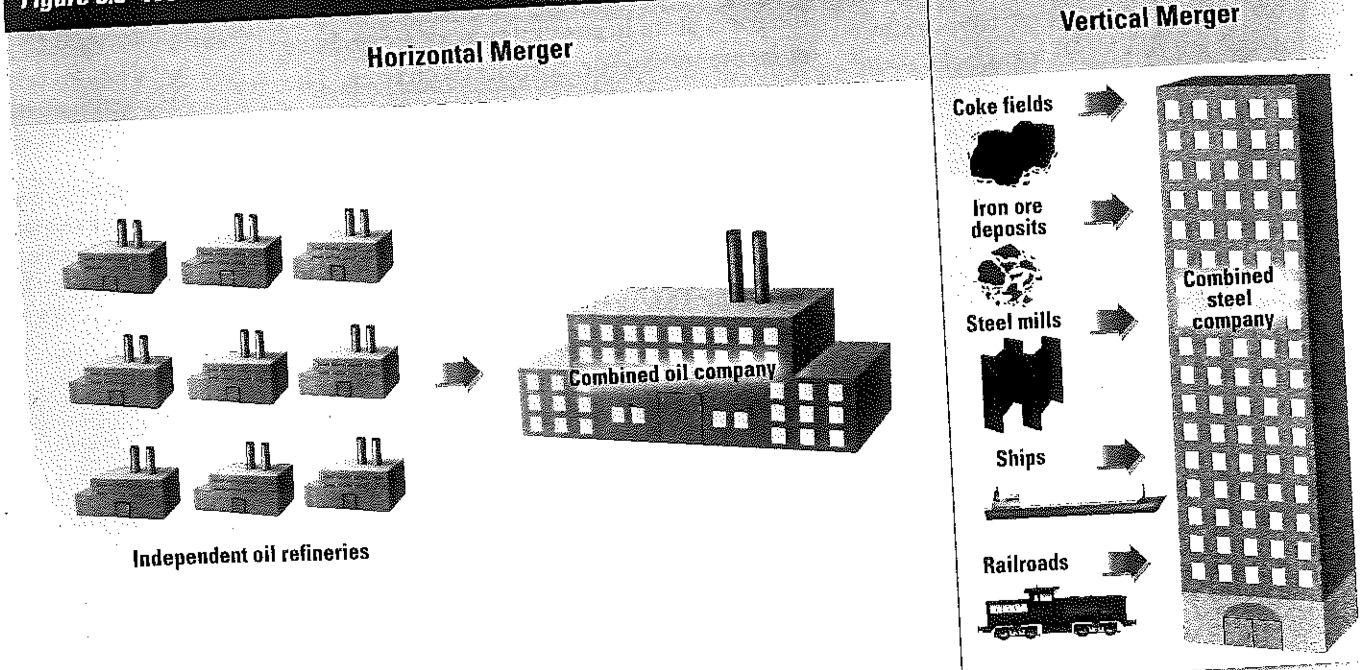
More Regulation

Corporations also face more regulations than other kinds of business organizations. Corporations must hold annual meetings for shareholders and keep careful records of all business transactions. Publicly held corporations are required to file quarterly and annual reports to the Securities and Exchange Commission (SEC). The SEC is a federal agency that regulates the stock market.

Corporate Combinations

As a corporation continues to grow, managers and owners may decide it makes

Figure 8.5 **Horizontal Merger and Vertical Merger**



BUILDING KEY CONCEPTS

Beginning in the 1880s, John D. Rockefeller's Standard Oil Company combined horizontally (left) with 40 other oil refineries. The power gained by Standard Oil and similar monopolies prompted passage of the Sherman Antitrust Act in 1890. In 1899, Andrew Carnegie established the Carnegie Steel Company. He used the vertical merger (right) to purchase ore mines, furnaces and mills, and even the shipping and railroad lines needed to transport his products to market. Within a short time, Carnegie controlled the steel industry. Most vertical mergers, however, do not result in monopolies. **Competition** **Explain the difference between horizontal and vertical mergers.**

sense to merge, or combine, the firm with another company or companies. The three kinds of mergers are horizontal mergers, vertical mergers, and conglomerates.

Each of these corporate combinations can lead to larger, more efficient firms. Often, larger firms can produce and sell their products at lower prices. However, their size can also give some of these combinations more monopoly power, as discussed in Chapter 7.

Horizontal mergers

Horizontal mergers join two or more firms competing in the same market with the same good or service. For example, in late 1998, two giant automakers, Chrysler Corporation and Daimler-Benz, merged to form DaimlerChrysler.

Two firms might choose to merge if the newly resulting firm would result in economies of scale or would otherwise improve efficiency. At the time of the merger, Chrysler Corporation and Daimler-Benz predicted that their merger would reduce costs and boost revenues as much as $3 billion dollars annually.

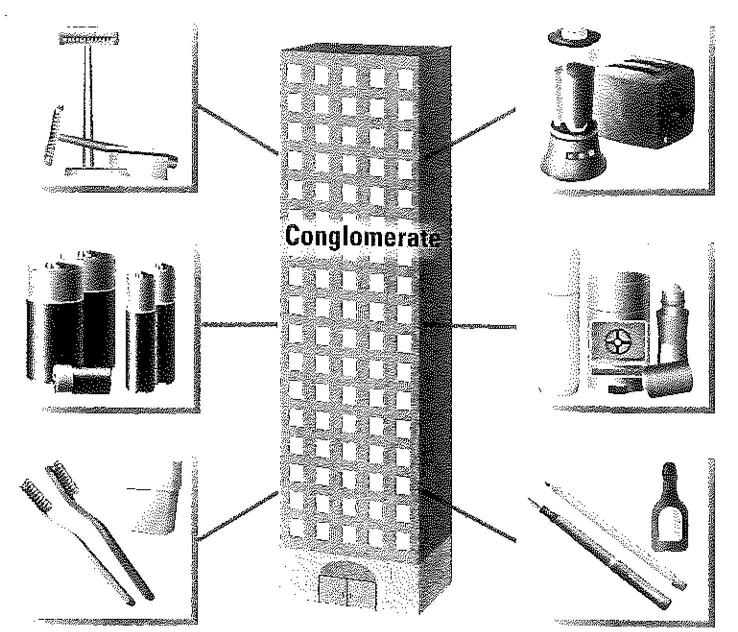
As you read in Chapter 7, the federal government watches horizontal mergers carefully. The resulting single firm might gain monopoly power in its market.

Vertical Mergers

Vertical mergers join two or more firms involved in different stages of producing the same good or service. A vertical merger can allow a firm to operate more efficiently. A vertically combined firm can control all phases of production, rather than rely on the goods or services of outside suppliers. Sometimes firms combine vertically out of fear that they may otherwise lose crucial supplies. To ensure production, these firms simply buy their suppliers.

Antitrust regulators become concerned when many firms in the same industry merge vertically if that merger drives supplying firms out of business. Most vertical mergers do not substantially lessen competition, however, so they are usually allowed.

Figure 8.6 A Conglomerate



Conglomerates combine diverse businesses.
Competition **Why don't conglomerates generally decrease competition?**

Conglomerates

Sometimes firms buy other companies that produce totally unrelated goods or services. These combinations, called **conglomerates,** have more than three businesses that make unrelated products. In a conglomerate, no one business earns the majority of the firm's profits. The government usually allows this kind of merger, because it does not result in decreased competition.

Multinational Corporations

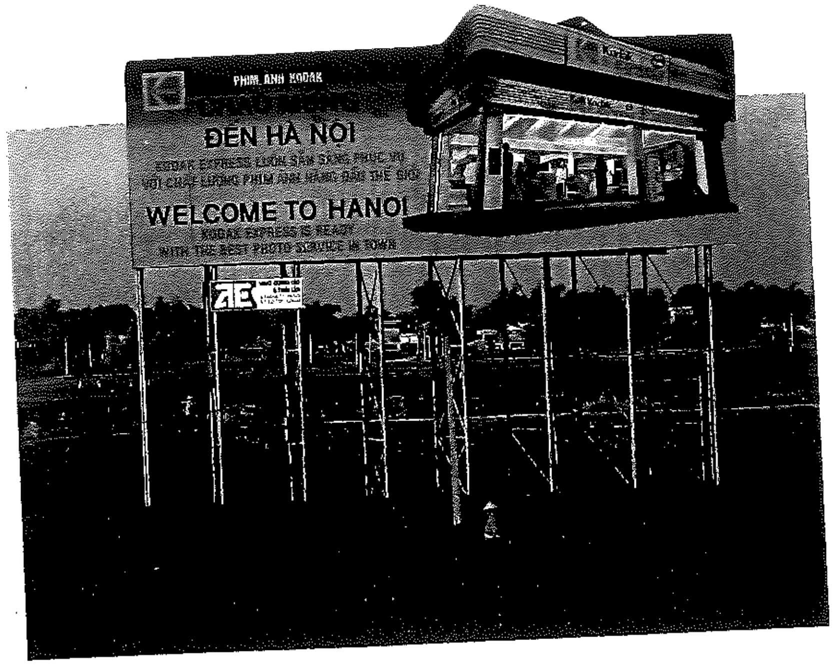
The world's largest corporations produce and sell their goods and services throughout the world. They are called **multinational corporations (MNCs).** MNCs are corporations that operate in more than one country at a time. They usually have headquarters in one country and branches in other countries. Multinationals, which are sometimes called transnational corporations, must obey laws and pay taxes in each country in which they operate. In the

horizontal merger *the combination of two or more firms competing in the same market with the same good or service*

vertical merger *the combination of two or more firms involved in different stages of producing the same good or service*

conglomerate *business combination merging more than three businesses that make unrelated products*

multinational corporation (MNC) *large corporation that produces and sells its goods and services throughout the world*



▲ **Multinational corporations make their presence felt throughout the world.**

late 1990s, an estimated 63,000 multinational firms operated about 690,000 foreign branches. They accounted for more than $3 trillion of worldwide assets. Many multinational corporations have operating budgets much bigger than most governments' budgets.

Corporations in the United States and Great Britain operated the world's largest multinationals in the 1970s and early 1980s. The picture today shows many different home countries for these giants, including Japan, South Korea, the Netherlands, and Italy.

Advantages of Multinationals

Multinationals benefit consumers and workers worldwide by providing jobs and products around the world. They also spread new technologies and production methods across the globe. Often the jobs they provide help poorer nations gain better living standards for their people.

Disadvantages of Multinationals

On the downside, many people feel that multinational firms unduly influence the culture and politics in the countries in which they operate. While some people feel that MNCs provide much needed jobs, critics are concerned about the low wages and poor working conditions provided by MNCs in some poorer countries. Whatever the advantages and disadvantages, trends suggest that MNCs will become increasingly visible and important in the world economy in the years ahead.

Section 3 Assessment

Key Terms and Main Ideas

1. How does a **corporation** differ from a sole proprietorship or partnership?
2. What is the difference between a **closely held corporation** and a **publicly held corporation?**
3. What information is required in a **certificate of incorporation?**
4. What is **stock?**
5. Why must stockholders pay taxes on **dividends?**
6. What is a merger? How do **horizontal mergers, vertical mergers,** and **conglomerates** differ?
7. Why are some corporations called **multinational corporations?**

Applying Economic Concepts

8. ***Critical Thinking*** Suppose you are deciding whether to incorporate your house-cleaning business. Analyze the consequences of this economic decision.
9. ***Try This*** Identify several sole proprietorships and partnerships in your neighborhood or town. Which of these businesses might benefit from incorporation? Explain your reasoning.
10. ***Critical Thinking*** How might a corporation benefit by being multinational?
11. ***Problem Solving*** You want to incorporate your family business. Will you form a closely held corporation or a publicly held corporation? Explain your reasoning.

Take It to the NET Use the Internet to identify a company that has been accused of exploiting foreign labor. What specific criticisms have been made? What is the company's response? Who do you think is right? Use the links provided in the Social Studies area at the following Web site for help in completing this activity. **www.phschool.com**