

PACE

Fourth Edition

Program for Acquiring Competence in Entrepreneurship

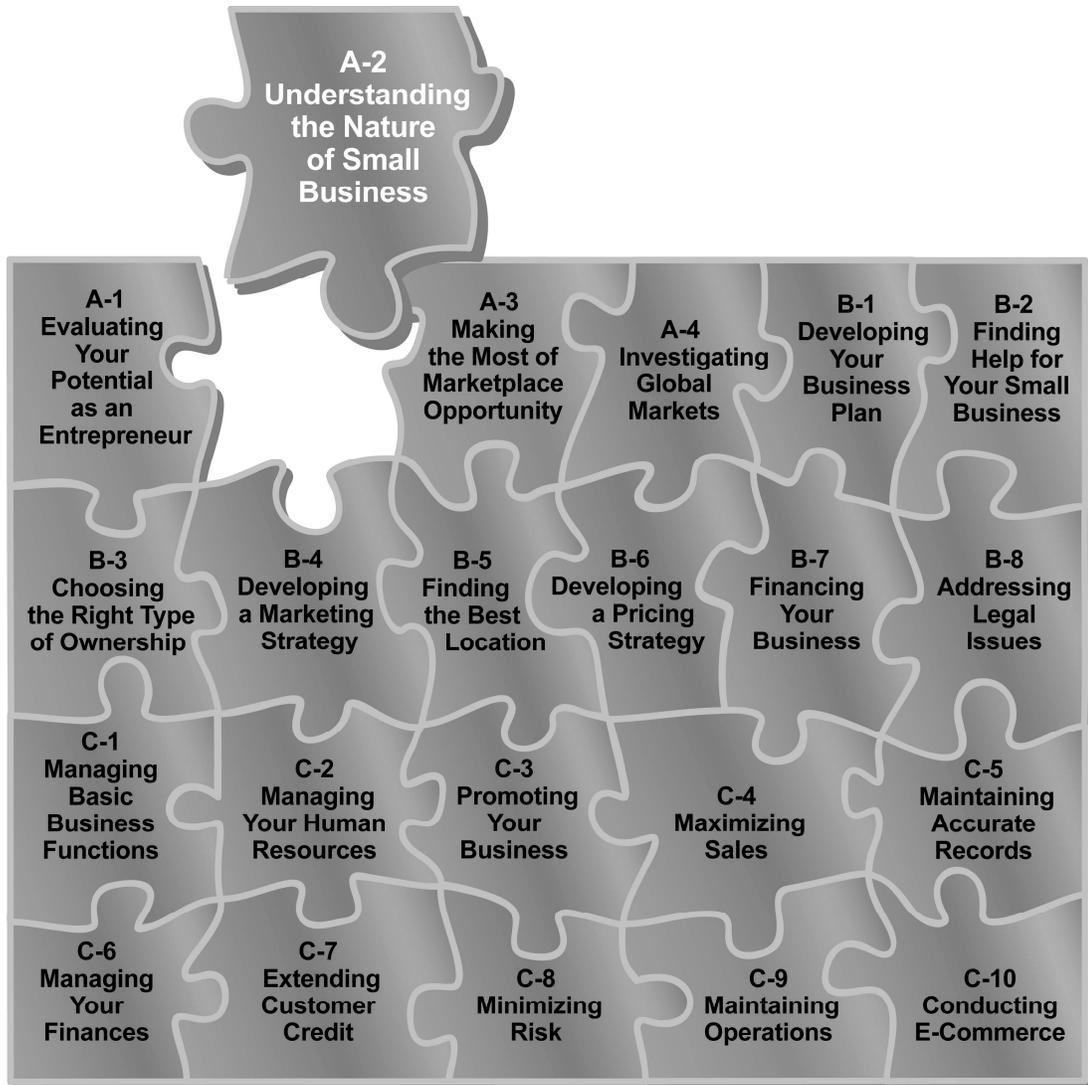


CENTER ON EDUCATION AND
TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
AND HUMAN ECOLOGY

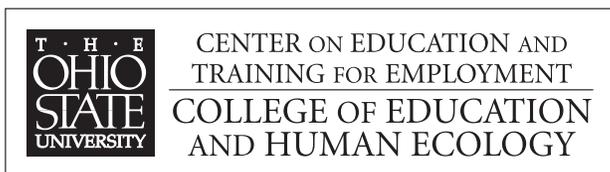
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Foreword

I am pleased to introduce you to the Fourth Edition of the Program for Acquiring Competence in Entrepreneurship (PACE). PACE represents our continuing effort to respond to the needs of the education and business communities. At no other time in history has understanding entrepreneurship been as important. For one thing, promoting entrepreneurship carries the societal imperative as small businesses as a whole contribute much to the growth and renewal of regional and national economies.

When first published in the late 1980s, PACE properly emphasized that entrepreneurship was based as much on sound planning as having products and services that were responsive to the marketplace. Through its various revisions, PACE continued to focus on the general importance of planning and managing the startup of a small business.

The current PACE edition represents a necessary break from past versions in both its format and some content. For one thing, the text format has been substantially changed from paragraphs to a series of related sections with subheadings. This change allows readers to have greater accessibility to the information, whether it is delivered via a printed booklet or a technology-based approach. And the format allows the instructor/facilitator to have greater flexibility in selecting content to accommodate the needs of various audiences and settings.

In terms of the content, PACE continues to emphasize the importance of planning and managing of a small business. But it now includes a renewed emphasis on meeting customer expectations. Any business cannot exist without a comprehensive understanding of who receives its products or services. In this sense, PACE introduces the topic of conducting e-commerce. Until recently, the entrepreneurial horizon may have been limited to serving local customers only. The advent of the Internet offers the promise of serving many more customers, but not without the accompanying challenges.

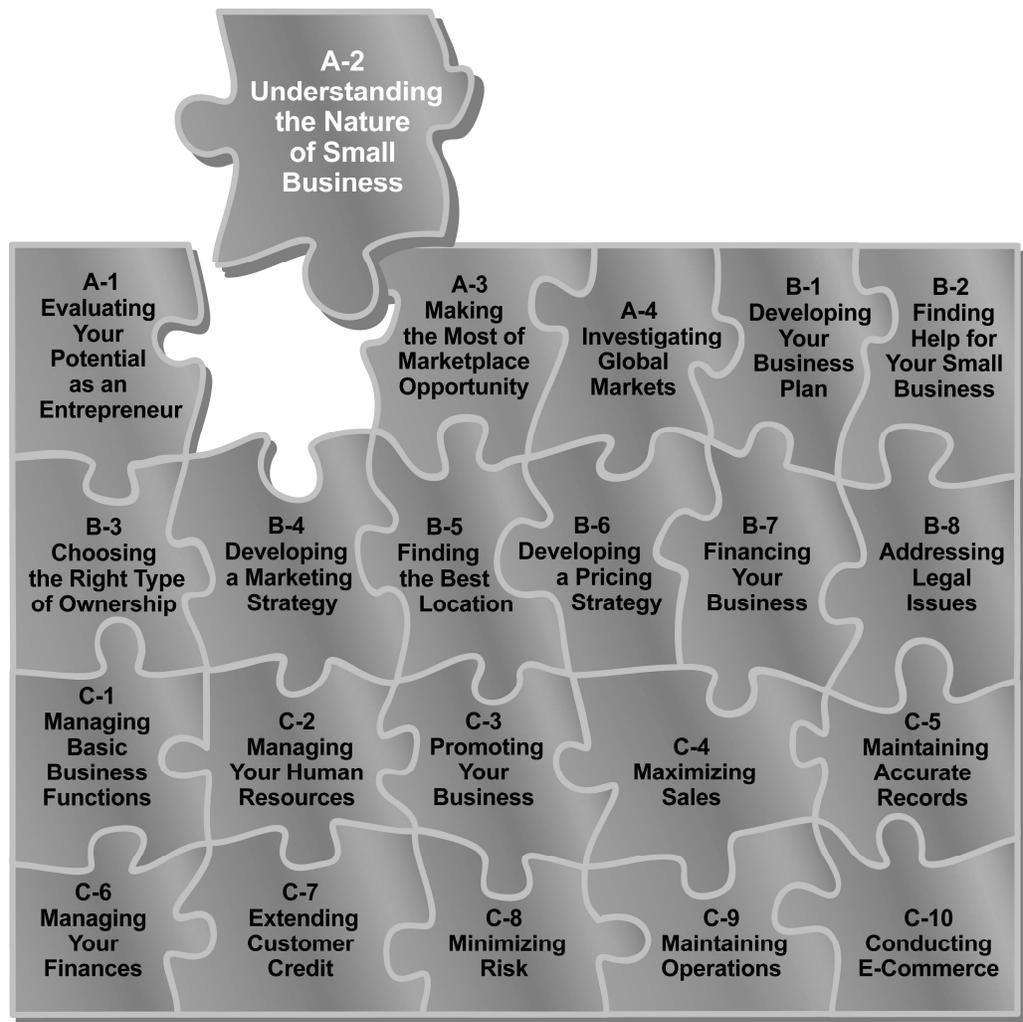
This edition was supported in part by a grant from OSU Extension and in partnership with OSU South Centers – Piketon. We hope that PACE will provide you with the understandings necessary to help you to achieve your entrepreneurship goals.

Ronald L. Jacobs
Director
Center on Education and Training for Employment

Overview

Introduction

Small business is comprised of a wide range of businesses in a vast array of industries. These organizations function within the framework of a system that has evolved over hundreds of years in response to consumer demand. This module presents some of the most important economic principles on which the American economy is founded and suggests ways to investigate the businesses and industries that have grown to prominence.



Continued on next page

Overview, Continued

Rationale Small business can be risky business, so understanding its very nature will give you the basis for making the soundest decisions possible.

Objectives By the conclusion of this module, you will be able to:

- Describe the nature of small business including:
 - the two major types of small business and their characteristics
 - the shift in focus of small business in recent years
 - classification systems used to research businesses and industries
 - the advantages and disadvantages of owning a small business.
- Explain the four elements of the free enterprise system.
- Describe the business environment in a consumer-driven economy.
- Summarize the three laws of the free enterprise system:
 - supply and demand
 - profit motive
 - free competition.
- Identify the opportunities and risks for small business in the international marketplace.

Relevant NCSEE standards This module aligns with the following National Content Standards for Entrepreneurship Education (NCSEE):

- C.01 Explain the role of business in society.
- C.03 Explain types of businesses.
- F.05 Describe the nature of economics and economic activities.
- F.07 Explain the principles of supply and demand.

More information on the NCSEE is available at http://www.entre-ed.org/Standards_Toolkit/.

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Overview, Continued

Topics

The topics in this module are:

| Topic | See Page |
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| Small Business in the International Marketplace | 16 |

Exhibits

The exhibits in this module are:

| Exhibit | See Page |
|--|-----------------|
| Summary of the Factors in Market Equilibrium | 13 |

Before You Begin

After reviewing the above objectives for this module, determine whether you can already meet those objectives and consult your instructor if you can.

The Small Business Environment

Introduction

Small business represents a cornerstone of our society. The Small Business Administration reports that small businesses, companies with under 500 employees, account for 99.7% of all employers in the United States. These small businesses employ over half of all private sector employees and produce 13 to 14 times more patents per employee than larger companies. The rise of the importance of small business is the result of more entrepreneurs. Many individuals are taking the risk to start their own business, for various reasons. You should thoroughly research your idea and consult others for input before investing into a venture to determine if a small business environment is for you.

As employers

Small businesses are major employers of both young and older workers, as well as veterans and minorities. They are a prominent force in promoting their work force to be innovative and develop new products and processes.

Think about your own community. If you take away small businesses, what would be left? It would seriously compromise your community's ability to meet consumer needs and keep the economy thriving.

Two types of small business

There are two major types of small business – micro and macro.

Micro-business – Micro-business represents the largest segment of small business. It is characterized by:

- 20 or fewer employees
- family or local ownership
- limited credit needs
- limited growth
- important to local employment.

Macro-business – Macro-business is characterized by:

- 20 or more employees
 - broad public and private owners
 - national or international scope
 - emphasis on research and development
 - significant investment in plants and equipment.
-

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The Small Business Environment, Continued

Shift in focus

The shift in the focus of business has been from manufacturing to service industries, and it has promoted a true entrepreneurial spirit. Small business has been innovative and responded well by providing the types of services that the American consumer demands.

Example: The biotechnology industry has experienced significant growth since its inception in the early 1970s. By 1980, there were slightly over 300 registered biotech companies. The number of businesses quadrupled by 1992 when over 1,200 registered biotech companies existed. In 2006, the growth rate has moderated slightly to approximately 1,500 businesses today.

Classification systems

There is one primary system for classifying businesses according to the industry in which they operate and the specific companies within each industry. Knowing the way your business is classified can help guide you to better understand the industry, your competitors, and suppliers. Potential business owners can use this information to determine supply or demand for particular products or services in their business area.

This information can be researched by examining North American Industry Classification System (NAICS) codes. The NAICS system categorizes businesses by the activity in which they are primarily engaged. Potential business owners can search for NAICS codes by visiting the U.S. Census Bureau website at <http://www.census.gov/epcd/www/naics.html>.

Once NAICS codes are determined, you can research barriers and opportunities in specific regions by using directories of various types. One such directory is the Harris Industrial Directory.

This resource is good for researching specific companies from the NAICS system of classifying the business by major industry group and a more narrowly defined industry category. It also allows both geographic and alphabetic searches. The Harris Industrial Directory will assist potential business owners in determining suppliers they may need as well as competitors they will face in the market.

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The Small Business Environment, Continued

Advantages vs. disadvantages

Enter into your new venture with solid data based on research and an open mind. The risks may not be as readily apparent as the benefits, so you need to carefully consider what might go wrong. The table below lists some of those factors.

| Advantages | Disadvantages |
|--|--|
| #1 – Personal achievement | #1 – Loss of personal time |
| <ul style="list-style-type: none">• Independence• Development of multiple skills• Use of talents and skills• Sense of responsibility• Flexibility• Sense of control• Leadership role | <ul style="list-style-type: none">• Fear of failure• Fear of lost reputation• Financial ruin• Loss of self confidence |

Investigate potential businesses and industries by:

- researching companies listed in your industry classification and related directories
- comparing and contrasting the above benefits and risks
- talking to established entrepreneurs as well as business owners who didn't succeed to find out what worked and what didn't.

With solid research, both objective and subjective, you can be better informed about the industry in which you are thinking about operating your business. Once you've decided that the nature of small business is compatible with your own goals and lifestyle, don't worry about the risks. Plan how to overcome them and then trust your decision.

Free Enterprise System

Introduction

With the growing number of small businesses in the United States, competition among businesses offering like products and services is at an all-time high. Businesses are continually enhancing their offering in order to secure sales to increase their profits. A small business either succeeds or fails depending on how well the entrepreneur responds to the laws of free enterprise and how efficiently he or she operates in a consumer-driven economy.

Four elements

Businesses operating today are based on economic principles founded by the father of modern economics, Adam Smith. He described a free enterprise system that was market-driven and based on these four basic elements:

- private property
 - free competition
 - freedom of choice
 - freedom from government intervention.
-

Private property

Adam Smith claimed that only with the private ownership of productive resources (such as land, factories, and equipment) could individuals be motivated to produce the goods and services needed by the community.

Note: Smith's contemporaries, including Thomas Jefferson, were also advocating for the need to give individuals both economic and political freedom in the form of property ownership.

Free competition

Adam Smith believed that *free competition* is a regulating force in the free enterprise system.

Definition of free competition – Free competition occurs when two or more businesses strive to supply their goods and services to the same market without outside interference from the government.

Results of free competition – When businesses have to compete for consumers, they're motivated to provide the highest quality at the lowest possible price, a definite benefit to the buyer of that product.

Continued on next page

Free Enterprise System, Continued

Free competition (continued)

Key point: Multiple competitors create an environment that works to prevent overcharging for products.

Attracting competitors – If one business has success in a certain market, the potential for profit attracts other businesses to the same arena.

Freedom of choice

Adam Smith proposed that in order for free competition to occur, you also need freedom of choice. In a free enterprise marketplace, the following conditions apply:

- Consumers decide which product to buy and from whom.
 - Businesses are free to choose the product that they'll produce or sell.
 - Since consumers are free to demand the products that satisfy their individual needs and desires, the business owner is compelled to offer the products that satisfy the customer.
-

Freedom from government intervention

The final cornerstone of Smith's free enterprise system is freedom from government intervention. Smith believed that:

- In a system of private property, free competition, and freedom of choice, there is no role for government in private business.
 - Government intervention couldn't improve upon the collective decisions of small business owners concerning what to offer in the marketplace and how much to provide.
-

Current situation

Today, these four basic elements of the free enterprise system are still in place. But government has attempted to ensure a fair and consistent business climate by regulating business in areas such as:

- antitrust
 - environment
 - labor
 - taxation.
-

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Free Enterprise System, Continued

How free enterprise works

In addition to the elements of free enterprise, Adam Smith also identified concrete principles that explain how the system works. The three prominent laws of free enterprise are:

- The Law of Supply and Demand
 - The Law of Profit Motive
 - The Law of Free Competition.
-

Consumer-Driven Economy

Introduction

Before addressing the laws of free enterprise, it's important to understand what a consumer-driven economy is since it serves as the basis of the free enterprise system. The main objective of business was defined by Peter Drucker in his classic work titled *The Practice of Management* (1959) as "to create a customer."

Key point: The consumer lies at the heart of the free enterprise system. You should design everything your business does to meet consumer demand.

Critical factors

The critical factors in a consumer-driven economy are customer care (through service and quality) and innovation. Tom Peters and Nancy Austin, co-authors of *A Passion For Excellence* (1985), explained the factor separating the truly superior businesses from the others as:

"In the private or public sector, in a big business or small, we observe that there are only two ways to create and sustain superior performance over the long haul. First, take exceptional care of your customers...via superior service and superior quality. Secondly, constantly innovate. That's it."

Power to the customer

Customers have a profound influence on how much of their product the business owner will provide and how much they can charge for their goods and services. Their power lies within how they choose to spend their money. The smart entrepreneur pays attention to these spending patterns and satisfies consumer need in order to make a profit.

Business environment

When considering your local business environment, there are several important factors to think about involving your customers. The main points to consider are:

- market
 - suppliers
 - competitors
 - growth trends
 - infrastructure
 - government regulations.
-

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Consumer-Driven Economy, Continued

Business environment (continued)

Market – Your market is the total number of potential buyers that you can identify to purchase your goods or services. Analyze the kinds of goods and services that people want to and are able to buy. Look at the following factors:

- demographics (sex, age, marital status, family size, stage of the family life cycle)
- psychographics (personality, lifestyle)
- socioeconomics (occupation, education, income, social class, culture).

Suppliers – Many businesses rely on other companies to supply goods and services to them. Reliable sources of competitively priced, high quality products are critical for the success of your business. The presence or absence of suppliers greatly impacts your ability to serve customers.

Competitors – Competition often varies from one geographic area to another. It's important to have a good understanding of who your competitors are and their strengths and weaknesses. Knowing whether competitors are meeting consumers needs will reveal where your opportunities lie and how to take advantage of them.

Growth trends – Your business will thrive in an area experiencing growth in the number of people and businesses which results in increased spending on goods and services. Assess these patterns to establish or expand your business in a manner that will lead to increased sales.

Infrastructure – The infrastructure that supports a community also affects your business's well being. It's easier to do business in an area with good highways, railroads, airports, and other basic systems in place. Other elements like local universities can sustain your business by providing a trained workforce and well-educated consumers.

Government regulations – Government jurisdiction is another factor that influences consumer behavior. Local, state, and federal governments all have the authority to enforce laws that affect everything from taxes to labor to the environment.

The Law of Supply and Demand

Introduction The law of supply and demand guides the marketplace activity in the consumer-driven economy. Customers determine the products that they want and in which quantities.

Supply Supply is the quantity of goods or services that providers offer at a given price at a specific time.

Example: Today your supermarket is offering microwaveable frozen dinners. Several producers are willing and able to provide this product to consumers at the marked price. If you add up all the microwaveable dinners in all the supermarkets in all the neighborhoods around the world, this amount would be the total supply of these dinners.

Demand Demand is the quantity of goods or services that consumers want to purchase at a given price at a specific time. Influences on demand include:

- consumer income level
- consumer preference
- season of the year
- consumer confidence in the economy.

Example: There are tens of thousands, maybe millions, of consumers who want to buy those microwaveable dinners today at their local supermarket. If you add up all the microwaveable dinners in all the supermarkets in all the neighborhoods around the world that customers buy, this amount would be the total demand for these dinners.

Gross domestic product Gross domestic product (GDP) is all the goods and services produced each year in a particular nation.

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The Law of Supply and Demand, Continued

Market equilibrium

The interaction of supply and demand results in market equilibrium. The market reaches equilibrium when the amount of product demanded and the amount supplied stabilize at a certain price.

Relationships – The table below summarizes the relationships between goods/services, pricing, and the business owner in achieving market equilibrium.

| If the amount of a good/service is too... | Then the price... | And business owners... |
|--|--------------------------|-----------------------------------|
| small | rises | provide more. |
| large | falls | provide less or leave the market. |

Example: The produce industry is a prime example of market equilibrium. In late summer when fruit like peaches is most plentiful, the price falls because the amount of peaches in the marketplace is large. Then in the winter when fewer growers can supply fresh peaches, the price rises. If you want peaches in January, you can get them but you'll pay a hefty price.

Effect on small business

Demand – Changing customer demand provides opportunity for the small business owner. As changes occur in the lives of consumers – income, lifestyle, want, and need – their demand for goods and services changes as well. You'll do well to recognize these changes.

Supply – Changing supply also affects small business. As supply increases, prices fall and profit margins suffer. Businesses that provide the product at the highest quality for the lowest price in the most efficient manner will grow and prosper.

Key point: The quicker you recognize these changes and respond, the more likely you are to succeed.

The Law of Profit Motive

Introduction Profit motivates business owners to assume the risk of producing goods or providing services in the hope that they will return a profit. In the free enterprise system, profit is the incentive that drives you to respond to supply and demand in a way that returns the most profit.

Facing the risk Every business venture involves some degree of risk since you invest time and money without any guarantee that customers will buy what you're offering. Because you expect to make a profit, you're willing to take that risk.

Effect on small business **Initial success** – Profit is a key motivator to small business owners. You take the risk because you believe that you have the potential to make a large profit and be considered a successful entrepreneur.

Continued success – After making enough profit to take care of your personal needs, the excess profit provides additional funds to reinvest in your business. And outside resources are attracted to firms with the highest profit potential, so the profit you've already made will be an indicator of future success and draw investors to you.

Key point: Success is measured as the amount of profit you make.

The Law of Free Competition

Introduction Competition is the force that drives the free enterprise system. It regulates the production of goods/services and sets the price that business owners can charge consumers.

Pressures The two pressures that impact supply and demand and also regulate prices are as follows:

- Consumers compete for available products, ensuring that business owners can cover their expenses and make a profit.
 - Business owners compete for sales to customers, ensuring that prices are reasonable and profits are not excessive.
-

Benefit to consumers Consumers benefit when businesses compete for their dollars. A competitive marketplace results in:

- lower prices as the supply increases and prices decrease
 - higher quality resulting from competitors wanting to supply the better product
 - increased variety as suppliers compete for a share of the marketplace by widening the selection to capture unmet demand
 - better service that responds to customer need quicker and more completely than competitors.
-

Effect on small business Intense competition affects small business both negatively and positively. When competitors vie for the same consumer dollar, it results in:

- lower profits as businesses decrease their prices to compete with each other
 - increased efficiency as lower profits lead to cost-cutting measures
 - elimination of inefficient businesses that cannot match the competition resulting in potentially larger demand and higher profits
 - market awareness that provides opportunity when changes occur.
-

Small Business in the International Marketplace

Introduction With the interdependence between nations for products that we want and need, small business truly competes in a world economy, or in the global village. The term *international trade* refers to the importing and exporting of goods and services between nations.

Opportunity As an entrepreneur, your opportunities in the global marketplace are great. People around the world will always have unmet demands. Your success depends on your ability to identify the scarcity of a product in a foreign country and become the main source of that item to those consumers.

Note: The United States represents about 25 percent of the total world GDP, leaving roughly 75 percent of the worldwide market wide open for small business to reach.

Risk As with any opportunity, risk is also part of the equation for success. International trade can be very complex, so approach it carefully. You can minimize the risk by expanding your understanding of the international business environment.

Resources To maximize your potential for success, start your inquiry into the global market by securing sound advice from a variety of resources. One of your main sources of information is the Department of Commerce. Besides the Department of Commerce, you can also gather information from:

- trade associations
 - banks
 - world trade clubs
 - state international trade offices.
-

PACE

Program for Acquiring Competence in Entrepreneurship

Fourth Edition

Cluster A – Exploring Entrepreneurship

Module A-1 Evaluating Your Potential as an Entrepreneur
Module A-2 Understanding the Nature of Small Business
Module A-3 Making the Most of Marketplace Opportunity
Module A-4 Investigating Global Markets

Cluster B – Planning for Business Success

Module B-1 Developing Your Business Plan
Module B-2 Finding Help for Your Small Business
Module B-3 Choosing the Right Type of Ownership
Module B-4 Developing a Marketing Strategy
Module B-5 Finding the Best Location
Module B-6 Developing a Pricing Strategy
Module B-7 Financing Your Business
Module B-8 Addressing Legal Issues

Cluster C – Business Management for the Entrepreneur

Module C-1 Managing Basic Business Functions
Module C-2 Managing Your Human Resources
Module C-3 Promoting Your Business
Module C-4 Maximizing Sales
Module C-5 Maintaining Accurate Records
Module C-6 Managing Your Finances
Module C-7 Extending Customer Credit
Module C-8 Minimizing Risk
Module C-9 Maintaining Operations
Module C-10 Conducting E-Commerce



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