

Table of contents:

[I Introduction to economic concept and tools 8](#_Toc327804614)

[Scarcity 8](#_Toc327804615)

[Scarcity in Economics 8](#_Toc327804616)

[Planned economy 8](#_Toc327804617)

[Economic planning versus the command economy 9](#_Toc327804618)

[Opportunity cost 10](#_Toc327804619)

[II Microeconomics 12](#_Toc327804620)

[Assumptions and definitions 12](#_Toc327804621)

[Supply and Demand 13](#_Toc327804622)

[Law of supply 13](#_Toc327804623)

[Law of demand 13](#_Toc327804624)

[Exceptions to the law of demand 14](#_Toc327804625)

[Aggregate supply 15](#_Toc327804626)

[Demand curve (aggregate demand in microeconomics) 16](#_Toc327804627)

[Circular flow of income 17](#_Toc327804628)

[Price discrimination 19](#_Toc327804629)

[Budget deficit 20](#_Toc327804630)

[Medium of exchange 20](#_Toc327804631)

[Division of labour 21](#_Toc327804632)

[Production possibilities frontier 22](#_Toc327804633)

[Efficiency 22](#_Toc327804634)

[Opportunity cost 23](#_Toc327804635)

[Marginal rate of transformation 24](#_Toc327804636)

[III Macroeconomics 27](#_Toc327804640)

[Basic macroeconomic concepts 27](#_Toc327804641)

[Aggregate demand 28](#_Toc327804642)

[Macroeconomic policies 29](#_Toc327804643)

[Fiscal policy 29](#_Toc327804644)

[Monetary policy 29](#_Toc327804645)

[Unemployment 29](#_Toc327804646)

[Inflation and deflation 30](#_Toc327804647)

[Diminishing returns 30](#_Toc327804648)

[Gross domestic product (GDP) 31](#_Toc327804649)

[Gross domestic income (GDI) 31](#_Toc327804650)

[Gross National Product (GNP) 31](#_Toc327804651)

[GDP vs. GNP 32](#_Toc327804652)

[Recession 32](#_Toc327804653)

[Marginal product 33](#_Toc327804654)

[Marginal cost 33](#_Toc327804655)

[Economies of scale 34](#_Toc327804656)

[Aggregation problem 35](#_Toc327804657)

[Trade 35](#_Toc327804658)

[Currency 36](#_Toc327804659)

[IV Organization of Industries 36](#_Toc327804660)

[Monopoly 36](#_Toc327804661)

[Market structures 37](#_Toc327804662)

[Characteristics 38](#_Toc327804663)

[Sources of monopoly power 38](#_Toc327804664)

[Oligopoly 40](#_Toc327804665)

[Characteristics 40](#_Toc327804666)

[Duopoly 41](#_Toc327804667)

[Perfect competition 41](#_Toc327804668)

[Basic structural characteristics 41](#_Toc327804670)

[Imperfect competition 42](#_Toc327804671)

[Monopolistic competition 43](#_Toc327804672)

[Major characteristics 43](#_Toc327804673)

[Perfect market 44](#_Toc327804674)

[General equilibrium theory 44](#_Toc327804675)

[Marginal product of labour 44](#_Toc327804676)

[Definition 44](#_Toc327804678)

[Examples 45](#_Toc327804679)

[V International Sector 46](#_Toc327804680)

[Comparative advantage 46](#_Toc327804681)

[Effect of trade costs 46](#_Toc327804682)

[Competitive advantage 47](#_Toc327804683)

[Free trade 48](#_Toc327804684)

[Features of free trade 48](#_Toc327804685)

[Terms of trade 49](#_Toc327804686)

[International trade 49](#_Toc327804689)

[Trade barriers 50](#_Toc327804690)

[Examples of free trade areas 51](#_Toc327804691)

[Public limited company 51](#_Toc327804692)

[Private company limited by shares 52](#_Toc327804694)

[Privately held company 55](#_Toc327804698)

[Tariffs 58](#_Toc327804699)

[Barriers to entry 59](#_Toc327804700)

[Customs union 60](#_Toc327804701)

[Import 60](#_Toc327804702)

[Export 60](#_Toc327804703)

[Foreign direct investment 61](#_Toc327804704)

[Stock 61](#_Toc327804705)

[Bond 61](#_Toc327804706)

[Multinational Corporation 62](#_Toc327804707)

[Globalization 62](#_Toc327804710)

[OPEC 62](#_Toc327804711)

[VI Money, Central Bank and Monetary Policy 63](#_Toc327804712)

[Federal Reserve System 63](#_Toc327804713)

[Fiscal policy 64](#_Toc327804714)

[Income 65](#_Toc327804715)

[Tax 65](#_Toc327804716)

[Value added tax 65](#_Toc327804717)

[European Union 66](#_Toc327804718)

[Economic union 67](#_Toc327804719)

[Competition Commission 67](#_Toc327804720)

[The role of the Competition Commission 67](#_Toc327804721)

[International Monetary Fund 69](#_Toc327804722)

[World Trade Organization 69](#_Toc327804723)

[U.S. Securities and Exchange Commission 70](#_Toc327804724)

[National Stock Exchange 70](#_Toc327804725)

[North American Free Trade Agreement 70](#_Toc327804726)

[Central European Free Trade Agreement 70](#_Toc327804727)

[NATO 70](#_Toc327804728)

[G8 71](#_Toc327804730)

[History 72](#_Toc327804731)

[Structure and activities 73](#_Toc327804732)

[Member facts 74](#_Toc327804733)

[BRIC 75](#_Toc327804734)

[Thesis 76](#_Toc327804735)

[History 78](#_Toc327804736)

[VIII Marketing 86](#_Toc327804738)

[International marketing 87](#_Toc327804739)

[Marketing research 87](#_Toc327804740)

[Key components 89](#_Toc327804741)

[Market segmentations 90](#_Toc327804742)

[Criteria for Segmenting 90](#_Toc327804743)

[Basis for segmenting consumer markets 90](#_Toc327804744)

[The marketing planning process 92](#_Toc327804745)

[Marketing strategy 92](#_Toc327804746)

[Developing a marketing strategy 93](#_Toc327804747)

[Competitor analysis 93](#_Toc327804748)

[Market environment 93](#_Toc327804749)

[Micro-Environment (internal environment) 94](#_Toc327804750)

[Macro-Environment (external environment) 95](#_Toc327804751)

[Consumer behaviour 96](#_Toc327804752)

[Buying behaviour 97](#_Toc327804753)

[Marketing mix 98](#_Toc327804754)

[Elements of the global marketing mix 99](#_Toc327804756)

[Promotional mix 100](#_Toc327804757)

[Mission statement 101](#_Toc327804758)

[Contents 101](#_Toc327804759)

[Vision statement 102](#_Toc327804760)

[PEST analysis 103](#_Toc327804761)

[Use of PEST analysis with other models 105](#_Toc327804764)

[SWOT analysis 105](#_Toc327804765)

[Porter five forces analysis 106](#_Toc327804766)

[Five forces 107](#_Toc327804767)

[Public relations 107](#_Toc327804768)

[Advertising 108](#_Toc327804769)

[Brand 109](#_Toc327804770)

[IX Management 110](#_Toc327804771)

[Operations management 113](#_Toc327804773)

[Strategic management 114](#_Toc327804774)

[Concepts/approaches of strategic management 115](#_Toc327804775)

[Strategy formation (Classical school) 115](#_Toc327804776)

[Benchmarking 119](#_Toc327804777)

[Core Competence 121](#_Toc327804780)

[Shareholder 122](#_Toc327804781)

[Stakeholder (corporate) 123](#_Toc327804782)

[Stock trader 126](#_Toc327804783)

[Stock traders and stock Investors 127](#_Toc327804784)

[Entrepreneurship 128](#_Toc327804785)

[Characteristics of an entrepreneur 129](#_Toc327804786)

[Concept 129](#_Toc327804787)

[Promotion 130](#_Toc327804788)

[Entrepreneur 130](#_Toc327804789)

[Leadership attributes 130](#_Toc327804790)

[Types of entrepreneurs 131](#_Toc327804792)

[Investor 133](#_Toc327804793)

[Types of investors 133](#_Toc327804794)

[Investor protection 134](#_Toc327804795)

[Investment 134](#_Toc327804796)

[X Accounting 136](#_Toc327804799)

[Accountant 137](#_Toc327804800)

[British Commonwealth 137](#_Toc327804801)

[Austria 140](#_Toc327804802)

[Hong Kong 140](#_Toc327804803)

[United States 141](#_Toc327804805)

[Accounting period 142](#_Toc327804806)

[Bookkeeping 142](#_Toc327804807)

[Chart of accounts 143](#_Toc327804808)

[Types of accounts 143](#_Toc327804809)

[General ledger 144](#_Toc327804810)

[Asset 146](#_Toc327804811)

[Asset characteristics 146](#_Toc327804812)

[Liability (financial accounting) 148](#_Toc327804813)

[Equity (finance) 149](#_Toc327804814)

[Equity investments 149](#_Toc327804815)

[Revenue 150](#_Toc327804816)

[Business revenue 150](#_Toc327804817)

[Government revenue 151](#_Toc327804818)

[Expense 152](#_Toc327804819)

[Bookkeeping for expenses 152](#_Toc327804820)

[Gain (finance) 153](#_Toc327804822)

[Cash flow statement 153](#_Toc327804823)

[Income statement 160](#_Toc327804827)

[Usefulness and limitations of income statement 160](#_Toc327804828)

[Sample income statement 164](#_Toc327804829)

[Bottom line 167](#_Toc327804830)

[Requirements of IFRS 167](#_Toc327804831)

[Balance sheet 168](#_Toc327804832)

[Public Business Entities balance sheet structure 170](#_Toc327804833)

[Sample balance sheet 171](#_Toc327804834)

[Accounting equation 173](#_Toc327804835)

[Accounts payable 174](#_Toc327804837)

[Overview 176](#_Toc327804839)

[Payment terms 177](#_Toc327804840)

[Accounts Receivable Age Analysis 177](#_Toc327804841)

# I Introduction to economic concept and tools

## Scarcity

­­­­­­­­­­­Scarcity is the fundamental [economic problem](http://en.wikipedia.org/wiki/Economic_problem) of having humans who have wants and needs in a world of limited [resources](http://en.wikipedia.org/wiki/Resource). It states that [society](http://en.wikipedia.org/wiki/Society) has insufficient productive resources to fulfill all human wants and needs. Alternatively, scarcity implies that not all of society's goals can be pursued at the same time; [trade-offs](http://en.wikipedia.org/wiki/Trade-off) are made of one good against others.

## Scarcity in Economics

­[Goods](http://en.wikipedia.org/wiki/Good_(economics)) (and [services](http://en.wikipedia.org/wiki/Service_(economics))) that are scarce are called economic goods (or simply *goods* if their scarcity is presumed). Other goods are called [free goods](http://en.wikipedia.org/wiki/Free_good) if they are desired but in such abundance that they are not scarce, such as air and seawater. Too much of something freely available can informally be referred to as a *bad*, but then its absence can be classified as a good, thus, a *mown* lawn, *clean* air, etc.

Economists study how societies perform the allocation of these resources — along with how communities often fail to attain optimality and are instead [inefficient](http://en.wikipedia.org/wiki/Inefficient). More clearly scarcity is our infinite wants hitting up against finite resources.

Certain goods are likely to remain inherently scarce by definition or by design; examples include [land](http://en.wikipedia.org/wiki/Land_(economics)) and [positional goods](http://en.wikipedia.org/wiki/Positional_good) such as awards generated by [honor systems](http://en.wikipedia.org/wiki/Honor_system), [fame](http://en.wikipedia.org/wiki/Celebrity), and membership of [elite](http://en.wikipedia.org/wiki/Elite) social groups. These things are said to derive all or most of their value from their scarcity. Even in a theoretical [post scarcity](http://en.wikipedia.org/wiki/Post_scarcity) society, certain goods, such as desirable [land](http://en.wikipedia.org/wiki/Land) and original [art](http://en.wikipedia.org/wiki/Art) pieces, would most likely remain scarce. But these may be seen as examples of artificial scarcity, reflecting societal institutions - for instance, the resource cost of giving someone the title of "[knight of the realm](http://en.wikipedia.org/wiki/Knight_of_the_realm)" is much less than the value that individuals attach to that [title](http://en.wikipedia.org/wiki/Title).

## Planned economy

A planned economy is an [economic system](http://en.wikipedia.org/wiki/Economic_system) in which decisions regarding production and investment are embodied in a plan formulated by a central authority, usually by a government agency. The justification for central planning is that the consolidation of economic resources can allow for the economy to take advantage of more [perfect information](http://en.wikipedia.org/wiki/Perfect_information) when making decisions regarding investment and production. In an entirely centralized economy, a universal survey of human needs and consumer wants is required before a comprehensive plan for production can be formulated. The state would require the power to allocate the workforce, for setting production values and for overseeing the distribution system of the economy. The most extensive form of a planned economy is referred to as a command economy,centrally planned economy, or command and control economy.

In such economies, central [economic planning](http://en.wikipedia.org/wiki/Economic_planning) by the [state](http://en.wikipedia.org/wiki/State_(polity)) or [government](http://en.wikipedia.org/wiki/Government) controls all major sectors of the economy and formulates all decisions about the use of resources.Planners decide what should be produced and direct lower-level enterprises to produce those goods in accordance with national and social objectives.

Planned economies are in contrast to [unplanned economies](http://en.wikipedia.org/wiki/Unplanned_economies), i.e. the [market economy](http://en.wikipedia.org/wiki/Market_economy) and proposed [self-managed economy](http://en.wikipedia.org/wiki/Self-managed_economy), where production, distribution, pricing, and investment decisions are made by autonomous firms based upon their individual interests rather than upon a [macroeconomic](http://en.wikipedia.org/wiki/Macroeconomics) plan. Less extensive forms of planned economies include those that use [indicative planning](http://en.wikipedia.org/wiki/Indicative_planning), in which the state employs "influence, subsidies, grants, and taxes, but does not compel."This latter is sometimes referred to as a "planned market economy".

A planned economy may consist of state-owned enterprises, cooperative enterprises, private enterprises directed by the state, or a combination of different enterprise types. Though "planned economy" and "command economy" are often used as synonyms, some make the distinction that under a command economy, enterprises need not follow a comprehensive plan of production. That is, a planned economy is "an economic system in which the government controls and regulates production, distribution, prices, etc."But a command economy, while also having this type of regulation, necessarily has substantial public ownership of industry.  Therefore, command economies are planned economies, but not necessarily the reverse.

## Economic planning versus the command economy

Economic planning is a mechanism for resource allocation of inputs and decision-making based on direct allocation, in contrast with the [market mechanism](http://en.wikipedia.org/wiki/Market_economy), which is based on indirect allocation. An economy based on economic planning (either through the state, an association of [worker cooperatives](http://en.wikipedia.org/wiki/Worker_cooperative) or another economic entity that has jurisdiction over the means of production) appropriates its resources as needed, so that allocation comes in the form of internal transfers rather than market transactions involving the purchasing of assets by one government agency or firm by another. Decision-making is carried out by workers and consumers on the enterprise-level.

This is contrasted with the concept of a centrally-planned, or command economy, where most of the economy is planned by a central government authority, and organized along a top-down administration where decisions regarding investment, production output requirements are decided upon by planners from the top, or near the top, of the chain of command. Advocates of economic planning have sometimes been staunch critics of command economies and centralized planning. For example, [Leon Trotsky](http://en.wikipedia.org/wiki/Leon_Trotsky) believed that central planners, regardless of their intellectual capacity, operated without the input and participation of the millions of people who participate in the economy and understand/respond to local conditions and changes in the economy would be unable to effectively coordinate all economic activity.

Another key difference is that command economies are strictly authoritarian in nature, whereas some forms of economic planning, such as [indicative planning](http://en.wikipedia.org/wiki/Indicative_planning), direct the economy through incentive-based methods. Economic planning can be practiced in a decentralized manner through different government authorities. For example, in some predominately market-oriented and mixed economies, the state utilizes economic planning in strategic industries such as the aerospace industry.

Another example of this is the utilization of [dirigisme](http://en.wikipedia.org/wiki/Dirigisme), both of which were practiced in France and Great Britain after the Second World War. Swedish public housing models were planned by the government in a similar fashion as [urban planning](http://en.wikipedia.org/wiki/Urban_planning). Mixed economies usually employ macroeconomic planning, while micro-economic affairs are left to the market and price system.

The [People's Republic of China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China) currently has a [socialist market economy](http://en.wikipedia.org/wiki/Socialist_market_economy) in place. Within this system, macroeconomic plans are used as general guidelines and as government goals for the national economy, but the majority of [state-owned enterprises](http://en.wikipedia.org/wiki/Government-owned_corporation) are subject to market forces. This is heavily contrasted to the command economy model of the former Soviet Union.

## Opportunity cost

Opportunity cost is the cost of any activity measured in terms of the value of the next best alternative forgone (that is not chosen). It is the sacrifice related to the second best choice available to someone, or group, who has picked among several [mutually exclusive](http://en.wikipedia.org/wiki/Mutually_exclusive) choices. The opportunity cost is also the cost of the forgone products after making a choice. Opportunity cost is a key concept in [economics](http://en.wikipedia.org/wiki/Economics), and has been described as expressing "the basic relationship between [scarcity](http://en.wikipedia.org/wiki/Scarcity) and [choice](http://en.wikipedia.org/wiki/Utility)". The notion of opportunity cost plays a crucial part in ensuring that scarce resources are used efficiently. Thus, opportunity costs are not restricted to monetary or financial costs: the [real cost](http://en.wikipedia.org/wiki/Real_versus_nominal_value_(economics)) of [output forgone](http://en.wikipedia.org/wiki/Production_possibilities_frontier), lost time, pleasure or any other benefit that provides [utility](http://en.wikipedia.org/wiki/Utility_(economics)) should also be considered opportunity costs.

**Opportunity costs in consumption**

Opportunity cost is assessed in not only monetary or material terms, but also in terms of anything which is of value. For example, a person who desires to watch each of two television programs being broadcast simultaneously, and does not have the means to make a recording of one, can watch only one of the desired programs. Therefore, the opportunity cost of watching *Dallas* could be not enjoying the other program (such as *Dynasty*). If an individual records one program while watching the other, the opportunity cost will be the time that the individual spends watching one program versus the other. In a restaurant situation, the opportunity cost of eating steak could be trying the salmon. The opportunity cost of ordering both meals could be twofold: the extra $20 to buy the second meal, and his reputation with his peers, as he may be thought of as greedy or extravagant for ordering two meals. A family might decide to use a short period of vacation time to visit Disneyland rather than doing household improvements. The opportunity cost of having happier children could therefore be a remodelled bathroom.

In [environmental protection](http://en.wikipedia.org/wiki/Environmental_protection), opportunity cost is also applicable. This has been demonstrated in the legislation that required the carcinogenic aromatics (mainly [reformate](http://en.wikipedia.org/wiki/Reformate)) to be largely eliminated from gasoline. Unfortunately, this required refineries to install equipment at a cost of hundreds of millions of dollars – and pass the cost to the consumer. The absolute number of cancer cases attributed to exposure to gasoline, however, is low, estimated a few cases per year in the U.S. Thus, the decision to require fewer aromatics has been criticized on the grounds of opportunity cost: the hundreds of millions of dollars spent on process redesign could have been spent on other, more fruitful ways of reducing deaths caused by cancer or automobiles. These actions (or strictly, the best one of them) are the opportunity cost of reduction of aromatics in gasoline

The Opportunity Cost of consuming good y, relative to good x (y:x), can be calculated by the price of good y, relative to good x (Py/Px). For example, a movie (good x) costs $10 (Px) and bowling (good y) costs $20 (Py), the opportunity cost of going bowling is 2 movies (Py/Px = 20/10). That is the $20 spent on bowling could have been used to see two movies priced at $10. Conversely the opportunity cost of going to watch a movie is 0.5 (10/20) games of bowling. Units should be specified in the opportunity cost, for example if forgoing 3 party invitations to go out on a date you would not say "I passed on 3 for this date", your date would need to know the units of the good forgone for the statement to make sense.

**Opportunity costs in production**

Opportunity costs may be assessed in the decision-making process of [production](http://en.wikipedia.org/wiki/Production_(economics)). If the workers on a farm can produce either one million pounds of wheat or two million pounds of barley, then the opportunity cost of producing one pound of wheat is the two pounds of barley forgone (assuming the production possibilities frontier is linear). Firms would make rational decisions by weighing the sacrifices involved.

### Explicit costs

Explicit costs are opportunity costs that involve direct monetary payment by producers. The opportunity cost of the [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) not already owned by a producer is the price that the producer has to pay for them. For instance, a firm spends $100 on electrical power consumed; their opportunity cost is $100. The firm has sacrificed $100, which could have been spent on other factors of production.

### Implicit costs

Implicit costs are the opportunity costs that in factors of production that a producer already owns. They are equivalent to what the factors could earn for the firm in alternative uses, either operated within the firm or rent out to other firms. For example, a firm pays $300 a month all year for rent on a warehouse that only holds product for six months each year. The firm could rent the warehouse out for the unused six months, at any price (assuming a year-long lease requirement), and that would be the cost that could be spent on other factors of production.

**Non-monetary opportunity costs**

Opportunity costs are not always monetary units or being able to produce one good over another. The opportunity cost can also be unknown, or spawn a series of infinite sub opportunity costs. For instance, an individual could choose not to ask a girl out on a date, in an attempt to make her more interested by playing hard to get, but the opportunity cost could be that they get completely ignored, which could lead to other opportunity costs.

# II Microeconomics

**Microeconomics** is a branch of [economics](http://en.wikipedia.org/wiki/Economics) that studies the behaviour of individual households and firms in making decisions on the allocation of limited resources. Typically, it applies to markets where goods or services are bought and sold. Microeconomics examines how these decisions and behaviours affect the [supply and demand](http://en.wikipedia.org/wiki/Supply_and_demand) for goods and services, which determines prices, and how prices, in turn, determine the quantity supplied and quantity demanded of goods and services.

This is in contrast to [macroeconomics](http://en.wikipedia.org/wiki/Macroeconomics), which involves the "sum total of economic activity, dealing with the issues of [growth](http://en.wikipedia.org/wiki/Economic_growth), [inflation](http://en.wikipedia.org/wiki/Inflation), and [unemployment](http://en.wikipedia.org/wiki/Unemployment)." Microeconomics also deals with the effects of national economic policies (such as changing [taxation](http://en.wikipedia.org/wiki/Taxation) levels) on the aforementioned aspects of the economy.

One of the goals of microeconomics is to analyze [market](http://en.wikipedia.org/wiki/Market) mechanisms that establish [relative prices](http://en.wikipedia.org/wiki/Relative_price) amongst goods and services and allocation of limited resources amongst many alternative uses. Microeconomics analyzes [market failure](http://en.wikipedia.org/wiki/Market_failure), where markets fail to produce efficient results, and describes the theoretical conditions needed for [perfect competition](http://en.wikipedia.org/wiki/Perfect_competition). Significant fields of study in microeconomics include [general equilibrium](http://en.wikipedia.org/wiki/General_equilibrium), markets under [asymmetric information](http://en.wikipedia.org/wiki/Asymmetric_information), choice under [uncertainty](http://en.wikipedia.org/wiki/Uncertainty) and economic applications of [game theory](http://en.wikipedia.org/wiki/Game_theory). Also considered is the [elasticity](http://en.wikipedia.org/wiki/Elasticity_(economics)) of products within the market system.

## Assumptions and definitions

The theory of [supply and demand](http://en.wikipedia.org/wiki/Supply_and_demand) usually assumes that markets are [perfectly competitive](http://en.wikipedia.org/wiki/Perfect_competition). This implies that there are many buyers and sellers in the market and none of them have the capacity to significantly influence prices of goods and services. In many real-life transactions, the assumption fails because some individual buyers or sellers have the ability to influence prices. Quite often, a sophisticated analysis is required to understand the demand-supply equation of a good model. However, the theory works well in situations meeting these assumptions.

[Mainstream economics](http://en.wikipedia.org/wiki/Mainstream_economics) does not assume [*a priori*](http://en.wikipedia.org/wiki/A_priori_and_a_posteriori_(philosophy)) that markets are preferable to other forms of social organization. In fact, much analysis is devoted to cases where so-called [market failures](http://en.wikipedia.org/wiki/Market_failure) lead to [resource allocation](http://en.wikipedia.org/wiki/Resource_allocation) that is suboptimal by some standard (defence spending is the classic example, profitable to all for use but not directly profitable for anyone to finance). In such cases, [economists](http://en.wikipedia.org/wiki/Economist) may attempt to find policies that will avoid waste, either directly by government control, indirectly by regulation that induces market participants to act in a manner consistent with optimal welfare, or by creating "[missing markets](http://en.wikipedia.org/wiki/Missing_market)" to enable efficient trading where none had previously existed. Market failure in positive economics (microeconomics) is limited in implications without mixing the belief of the economist and his or her theory.

The demand for various commodities by individuals is generally thought of as the outcome of a utility-maximizing process, with each individual trying to maximize their own utility. The interpretation of this relationship between price and quantity demanded of a given good assumes that, given all the other goods and constraints, the set of choices which emerges is that one which makes the consumer happiest.

## Supply and Demand

**Supply and demand** is an [economic model](http://en.wikipedia.org/wiki/Economic_model) of [price determination](http://en.wikipedia.org/wiki/Price_determination) in a [market](http://en.wikipedia.org/wiki/Market). It concludes that in a [competitive market](http://en.wikipedia.org/wiki/Perfect_competition), the [unit price](http://en.wikipedia.org/wiki/Unit_price) for a particular good will vary until it settles at a point where the quantity demanded by consumers (at current price) will equal the quantity supplied by producers (at current price), resulting in an [economic equilibrium](http://en.wikipedia.org/wiki/Economic_equilibrium) of price and quantity.

The four basic laws of supply and demand are:

1. If demand increases and supply remains unchanged, then it leads to higher equilibrium price and higher quantity.
2. If demand decreases and supply remains unchanged, then it leads to lower equilibrium price and lower quantity.
3. If supply increases and demand remains unchanged, then it leads to lower equilibrium price and higher quantity.
4. If supply decreases and demand remains unchanged, then it leads to higher equilibrium price and lower quantity.

## Law of supply

The Law of Supply states that, (all other things unchanged) an increase in price results in an increase in quantity supplied. This means that producers are willing to offer more products for sale on the market at higher prices by increasing production as a way of increasing profits.

## Law of demand

In [economics](http://en.wikipedia.org/wiki/Economics), the **law of demand** is an economic law, which states that [consumers](http://en.wikipedia.org/wiki/Consumer) buy more of a good when its price decreases and less when its price increases ([ceteris paribus](http://en.wikipedia.org/wiki/Ceteris_paribus)).

The greater the amount to be sold, the smaller the price at which it is offered must be, in order for it to find purchasers.

Law of demand states that the amount demanded of a [commodity](http://en.wikipedia.org/wiki/Commodity) and its price are inversely related, other things remaining constant. That is, if the [income](http://en.wikipedia.org/wiki/Income) of the consumer, prices of the related [goods](http://en.wikipedia.org/wiki/Goods), and tastes and preferences of the consumer remain unchanged, the consumer’s demand for the good will move opposite to the movement in the price of the good.

**Assumptions**

Every law will have limitations or exceptions. While expressing the law of demand, the assumption is that other conditions of demand are unchanged. If they remain constant, the inverse relation may not hold well. In other words, it is assumed that the income and tastes of consumers and the prices of other commodities are constant. This law operates when the commodity’s price changes and all other prices and conditions do not change.

The main assumptions are:

* Habits, tastes and fashions remain constant.
* Money, income of the consumer does not change.
* Prices of other goods remain constant.
* The commodity in question has no [substitute](http://en.wikipedia.org/wiki/Substitute_good) or is not in competition by other goods.
* The commodity is a [normal good](http://en.wikipedia.org/wiki/Normal_good) and has no prestige or status value.
* People do not expect changes in the price.
* Price is independent and demand is dependent.

**Exceptions to the law of demand**

Generally, the amount demanded of good increases with a decrease in price of the good and vice versa. In some cases, however, this may not be true. Such situations are explained below.

### Giffen goods

Initially discovered by [Robert Giffen](http://en.wikipedia.org/wiki/Robert_Giffen), economists disagree on the existence of Giffen goods in the market. A Giffen good describes an inferior good that as the price increases demand for the product increases. As an example, during the [Irish Potato Famine](http://en.wikipedia.org/wiki/Great_Famine_(Ireland)) of the 19th century, potatoes were considered a Giffen good. Potatoes were the largest staple in the Irish diet, so as the price rose it had a large impact on income. People responded by cutting out on [luxury goods](http://en.wikipedia.org/wiki/Luxury_good) such as meat and vegetables, and instead bought more potatoes. Therefore, as the price of potatoes increased, so did the demand.

### Commodities which are used as status symbols

Some expensive commodities like diamonds, air conditioned cars, etc., are used as status symbols to display one’s wealth. The more expensive these commodities become, the higher their value as a status symbol and hence, the greater the demand for them. The amount demanded of these commodities increase with an increase in their price and decrease with a decrease in their price. Also known as a [Veblen good](http://en.wikipedia.org/wiki/Veblen_good).

### Expectation of change in the price of commodity

If a household expects the price of a commodity to increase, it may start purchasing a greater amount of the commodity even at the presently increased price. Similarly, if the household expects the price of the commodity to decrease, it may postpone its purchases. Thus, law of demand is violated in such cases. In this case, the demand curve does not slope down from left to right; instead it presents a backward slope from the top right to down left. This curve is known as an exceptional demand curve. Technically, this is not a violation of the law of demand, as it violates the [ceteris paribus](http://en.wikipedia.org/wiki/Ceteris_paribus) condition.

**Law of demand and changes in demand**

The law of demand states that, other things remaining same, the quantity demanded of a good increases when its price falls and vice-versa. Note that demand for goods changes as a consequence of changes in income, tastes etc. Hence, demand may expand or contract and increase or decrease. In this context, let us make a distinction between two different types of changes that affect quantity demanded, viz., expansion and contraction; and increase and decrease.

While stating the law of demand i.e., while treating price as the causative factor, the relevant terms are Expansion and Contraction in demand. When demand is changing due to a price change alone, we should not say increase or decrease but expansion or contraction. If one of the non-price determinants of demand, such as the prices of other goods, income, etc. change & thereby demand changes, the relevant terms are increase and decrease in demand.

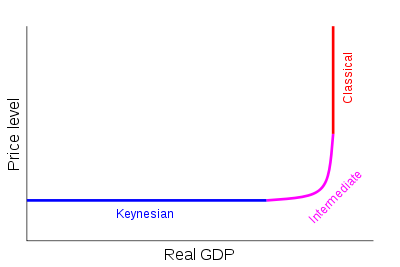
**Limitations:**

* Change in taste or fashion.
* Change in income
* Change in other prices.
* Discovery of substitution.
* Anticipatory change in prices.
* Rare or distinction goods.

There are certain goods which do not follow this law. These include Veblen goods and Giffen goods.

## Aggregate supply

In economics, aggregate supply is the total supply of goods and services that firms in a national economy plan on selling during a specific time period. It is the total amount of goods and services that firms are willing to sell at a given price level in an economy.



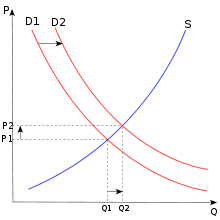
Aggregate supply curve showing the three ranges: Keynesian, Intermediate, and Classical.

**Different scopes**

There are generally three forms of aggregate supply (AS). They are:

* *Short run aggregate supply* (SRAS) — During the short-run, firms possess one fixed factor of production (usually capital). This does not however prevent outward shifts in the SRAS curve, which will result in increased output/real GDP at a given price. Therefore, a positive correlation between price level and output is shown by the SRAS curve.
* *Long run aggregate supply* (LRAS) — over the long run, only capital, labour, and technology affect the LRAS in the macroeconomic model because at this point everything in the economy is assumed to be used optimally. In most situations, the LRAS is viewed as static because it shifts the slowest of the three. The LRAS is shown as perfectly vertical, reflecting economists' belief that changes in aggregate demand (AD) have an only temporary change on the economy's total output.
* *Medium run aggregate supply* (MRAS) — as an interim between SRAS and LRAS, the MRAS form slopes upward and reflects when capital as well as labour can change. More specifically, the Medium run aggregate supply is like this for three theoretical reasons, namely the Sticky-Wage Theory, the Sticky-Price Theory and the Misperception Theory. When graphing an aggregate supply and demand model, the MRAS is generally graphed after aggregate demand (AD), SRAS, and LRAS have been graphed, and then placed so that the equilibria occur at the same point. The MRAS curve is affected by capital, labour, technology, and wage rate.

## Demand curve (aggregate demand in microeconomics)

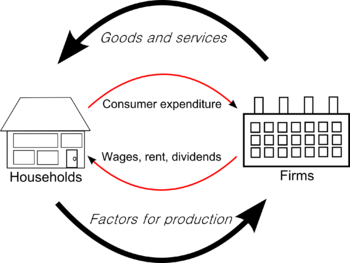
[](http://en.wikipedia.org/wiki/File:Supply-and-demand.svg)

An example of a demand curve shifting

In [economics](http://en.wikipedia.org/wiki/Economics), the demand curve is the [graph](http://en.wikipedia.org/wiki/Graph_of_a_function) depicting the relationship between the price of a certain [commodity](http://en.wikipedia.org/wiki/Commodity) and the amount of it that consumers are willing and able to purchase at that given price. It is a graphic representation of a demand schedule. The demand curve for all consumers together follows from the demand curve of every individual consumer: the individual demands at each price are added together.

Demand curves are used to estimate behaviours in [competitive markets](http://en.wikipedia.org/wiki/Perfect_competition), and are often combined with [supply curves](http://en.wikipedia.org/wiki/Supply_curve) to estimate the [equilibrium price](http://en.wikipedia.org/wiki/Equilibrium_price) (the price at which sellers together are willing to sell the same amount as buyers together are willing to buy, also known as [market clearing](http://en.wikipedia.org/wiki/Market_clearing) price) and the equilibrium quantity (the amount of that good or service that will be produced and bought without surplus/excess supply or shortage/excess demand) of that market. In a monopolistic market, the demand curve facing the monopolist is simply the market demand curve.

## Circular flow of income



In [economics](http://en.wikipedia.org/wiki/Economics), the terms **circular flow of income** or **circular flow** refer to a simple economic model which describes the reciprocal circulation of income between producers and consumers. In the circular flow model, the inter-dependent entities of producer and consumer are referred to as "firms" and "households" respectively and provide each other with factors in order to facilitate the flow of income. Firms provide consumers with goods and services in exchange for consumer expenditure and "[factors of production](http://en.wikipedia.org/wiki/Factors_of_production)" from households. More complete and realistic circular flow models are more complex. They would explicitly include the roles of government and financial markets, along with imports and exports.

Human wants are unlimited and are of recurring nature therefore, production process remains a continuous and demanding process. In this process, household sector provides various factors of production such as land, labour, capital and enterprise to producers who produce by goods and services by co-coordinating them. Producers or business sector in return makes payments in the form of rent, wages, interest and profits to the household sector. Again household sector spends this income to fulfil its wants in the form of consumption expenditure. Business sector supplies those goods and services produced and get income in return of it. Thus expenditure of one sector becomes the income of the other and supply of goods and services by one section of the community becomes demand for the other. This process is unending and forms the circular flow of income, expenditure and production.

A continuous flow of production, income and expenditure is known as circular flow of income. It is circular because it has neither any beginning nor an end. The circular flow of income involves two basic principles:

1. In any exchange process, the seller or producer receives the same amount what buyer or consumer spends.
2. Goods and services flow in one direction and money payment to get these flow in return direction, causes a circular flow.

Circular flows are classified as: Real Flow and Money Flow. Real Flow- In a simple economy, the flow of factor services from households to firms and corresponding flow of goods and services from firms to households s known to be as real flow.

Assume a simple two sector economy- household and firm sectors, in which the households provides factor services to firms, which in return provides goods and services to them as a reward. Since there will be an exchange of goods and services between the two sectors in physical form without involving money, therefore, it is known as real flow.

Money Flow- In a modern two sector economy, money acts as a medium of exchange between goods and factor services. Money flow of income refers to a monetary payment from firms to households for their factor services and in return monetary payments from households to firms against their goods and services. Household sector gets monetary reward for their services in the form of rent, wages, interest, and profit form firm sector and spends it for obtaining various types of goods to satisfy their wants. Money acts as a helping agent in such an exchange.

**Assumptions**

The basic circular flow of income model consists of seven assumptions:

1. The economy consists of two sectors: [households](http://en.wikipedia.org/wiki/Households) and [firms](http://en.wiktionary.org/wiki/firm).
2. Households spend all of their [income](http://en.wikipedia.org/wiki/Income) (Y) on [goods and services](http://en.wikipedia.org/wiki/Goods_and_services) or [consumption](http://en.wikipedia.org/wiki/Consumption_(economics)) (C). There is no saving (S).
3. All output (O) produced by firms is purchased by households through their [expenditure](http://en.wikipedia.org/wiki/Expenditure) (E).
4. There is no [financial](http://en.wikipedia.org/wiki/Financial) sector.
5. There is no [government](http://en.wikipedia.org/wiki/Government) sector.
6. There is no [overseas](http://en.wikipedia.org/wiki/Overseas) sector.
7. It is a closed economy with no exports or imports.

## Price discrimination

**Price discrimination** or **price differentiation**exists when sales of identical goods or services are transacted at different [prices](http://en.wikipedia.org/wiki/Price) from the same provider. In a theoretical market with [perfect information](http://en.wikipedia.org/wiki/Perfect_information), [perfect substitutes](http://en.wikipedia.org/wiki/Substitute_good), and no [transaction costs](http://en.wikipedia.org/wiki/Transaction_cost) or prohibition on secondary exchange (or re-selling) to prevent [arbitrage](http://en.wikipedia.org/wiki/Arbitrage), price discrimination can only be a feature of [monopolistic](http://en.wikipedia.org/wiki/Monopoly) and [oligopolistic](http://en.wikipedia.org/wiki/Oligopoly) [markets](http://en.wikipedia.org/wiki/Market), where [market power](http://en.wikipedia.org/wiki/Market_power) can be exercised. Otherwise, the moment the seller tries to sell the same good at different prices, the buyer at the lower price can arbitrage by selling to the consumer buying at the higher price but with a tiny discount. However, product heterogeneity, [market frictions](http://en.wikipedia.org/wiki/Frictionless_market) or high fixed costs (which make marginal-cost pricing unsustainable in the long run) can allow for some degree of differential pricing to different consumers, even in fully competitive retail or industrial markets. Price discrimination also occurs when the same price is charged to customers which have different supply costs.

The effects of price discrimination on [social efficiency](http://en.wikipedia.org/wiki/Social_efficiency) are unclear; typically such behaviour leads to lower prices for some consumers and higher prices for others. Output can be expanded when price discrimination is very efficient, but output can also decline when discrimination is more effective at extracting surplus from high-valued users than expanding sales to low valued users. Even if output remains constant, price discrimination can reduce efficiency by misallocating output among consumers.

Price discrimination requires [market segmentation](http://en.wikipedia.org/wiki/Market_segmentation) and some means to discourage discount customers from becoming resellers and, by extension, competitors. This usually entails using one or more means of preventing any resale, keeping the different price groups separate, making price comparisons difficult, or restricting pricing information. The boundary set up by the marketer to keep segments separate is referred to as a *rate fence*. Price discrimination is thus very common in services where resale is not possible; an example is student discounts at museums. Price discrimination in [intellectual property](http://en.wikipedia.org/wiki/Intellectual_property) is also enforced by law and by technology. In the market for DVDs, DVD players are designed - by law - with chips to prevent an inexpensive copy of the DVD (for example legally purchased in India) from being used in a higher price market (like the US). The [Digital Millennium Copyright Act](http://en.wikipedia.org/wiki/Digital_Millennium_Copyright_Act) has provisions to outlaw circumventing of such devices to protect the enhanced monopoly profits that copyright holders can obtain from price discrimination against higher price market segments.

Price discrimination can also be seen where the requirement that goods be identical is relaxed. For example, so-called "premium products" (including relatively simple products, such as cappuccino compared to regular coffee) have a price differential that is not explained by the cost of production. Some economists have argued that this is a form of price discrimination exercised by providing a means for consumers to reveal their willingness to pay.

## Budget deficit

A government budget deficit is the amount by which some measure of government revenues falls short of some measure of government spending.

If a government is running a positive budget deficit, it is also said to be running a negative budget surplus.

A **government**[**budget**](http://en.wikipedia.org/wiki/Budget) is a legal document that is often passed by the [legislature](http://en.wikipedia.org/wiki/Legislature), and approved by the [chief executive](http://en.wikipedia.org/wiki/Chief_executive)-or president. For example, only certain types of revenue may be imposed and collected. [Property tax](http://en.wikipedia.org/wiki/Property_tax) is frequently the basis for [municipal](http://en.wikipedia.org/wiki/Municipal) and [county](http://en.wikipedia.org/wiki/County) revenues, while [sales tax](http://en.wikipedia.org/wiki/Sales_tax) and/or [income tax](http://en.wikipedia.org/wiki/Income_tax) are the basis for state revenues, and [income tax](http://en.wikipedia.org/wiki/Income_tax) and [corporate tax](http://en.wikipedia.org/wiki/Corporate_tax) are the basis for national revenues.

The two basic elements of any budget are the [revenues](http://en.wikipedia.org/wiki/Revenues) and [expenses](http://en.wikipedia.org/wiki/Expenses). In the case of the government, [revenues](http://en.wikipedia.org/wiki/Revenue) are derived primarily from [taxes](http://en.wikipedia.org/wiki/Tax). [Government expenses](http://en.wikipedia.org/wiki/Government_expense) include spending on current goods and services, which economists call [government consumption](http://en.wikipedia.org/wiki/National_Income_and_Product_Accounts#Accounting_for_National_Product:_The_Right_Side_of_the_Report); [government investment expenditures](http://en.wikipedia.org/wiki/National_Income_and_Product_Accounts#Accounting_for_National_Product:_The_Right_Side_of_the_Report) such as infrastructure investment or research expenditure; and [transfer payments](http://en.wikipedia.org/wiki/Transfer_payment) like unemployment or retirement benefits.

Budgets have an economic, political and technical basis. Unlike a pure economic budget, they are not entirely designed to allocate [scarce](http://en.wikipedia.org/wiki/Scarcity) resources for the best economic use. They also have a political basis wherein different interests push and pull in an attempt to obtain benefits and avoid burdens. The technical element is the forecast of the likely levels of revenues and expenses.

## Medium of exchange

Money is the common Medium of Exchange and its most important and essential function is that it is 'measure of value'. Hifzur Rab has shown that market measures or sets value of various goods and services using the medium of exchange/money as 'unit' i.e., standard or the Yard Stick of Measurement of Wealth. There is no other alternative to the mechanism used by market to set or determine or measure value of various goods and services and therefore wealth. Just determination of prices is an essential condition for justice in exchange, efficient allocation of resources, economic growth welfare and justice. Money helps us in gaining power of buying. Thus, this is the most important and essential function of money. To be widely acceptable, a medium of exchange should have stable purchasing power (Value) and therefore it should possess the following characteristics:

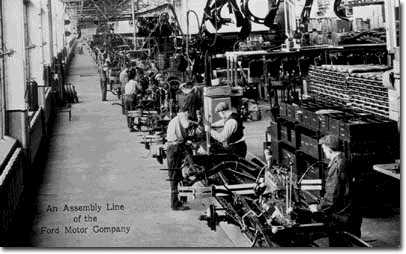
1. value common assets
2. constant utility
3. low cost of preservation
4. transportability
5. divisibility
6. high market value in relation to volume and weight
7. resistance to counterfeiting

To serve as a measure of value, a medium of exchange, be it a good or signal, needs to have constant inherent value of its own or it must be firmly linked to a definite basket of goods and services. It should have constant intrinsic value and stable purchasing power. Gold was long popular as a medium of exchange *and* store of value because it was [inert](http://en.wikipedia.org/wiki/Inert), was convenient to move due to even small amounts of gold having considerable value, had a constant value due to its special physical and chemical properties, and was cherished by men.

Critics of the prevailing system of [fiat money](http://en.wikipedia.org/wiki/Fiat_money) argue that fiat money is the root cause of the continuum of economic crises, since it leads to the dominance of fraud, corruption, and manipulation precisely because it does not satisfy the criteria for a medium of exchange cited above. Specifically, prevailing fiat money is free float and depending upon its supply market finds or sets a value to it that continues to change as the supply of money is changed with respect to the economy's demand. Increasing free floating money supply with respect to needs of the economy reduces the quantity of the basket of the goods and services to which it is linked by the market and that provides it purchasing power. Thus it is not a unit or standard measure of wealth and its manipulation impedes the market mechanism by that it sets/determine just prices. That leads us to a situation where no value-related economic data is just or reliable. On the other hand, [Chartalists](http://en.wikipedia.org/wiki/Chartalism) claim that the ability to manipulate the value of fiat money is an advantage, in that fiscal stimulus is more easily available in times of economic crisis.

## Division of labour

Division of labour is the specialization of cooperative labour in specific, circumscribed tasks and like roles. Historically an increasingly complex division of labour is closely associated with the growth of total output and trade, the rise of capitalism, and of the complexity of industrialization processes. Division of labour was also a method used by the Sumerians to categorize different jobs, and divide them to skilled members of a society.

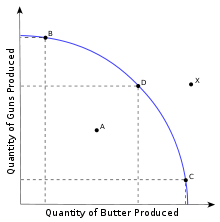


## Production possibilities frontier

In [economics](http://en.wikipedia.org/wiki/Economics), a production–possibility curve (PPC), sometimes called a production–possibility frontier, production-possibility boundary or product transformation curve, is a graph that compares the production rates of two commodities that use the same fixed total of the [factors of production](http://en.wikipedia.org/wiki/Factors_of_production). Graphically bounding the [production set](http://en.wikipedia.org/wiki/Production_set), the PPF curve shows the maximum specified production level of one commodity that results given the production level of the other. By doing so, it defines [productive efficiency](http://en.wikipedia.org/wiki/Productive_efficiency) in the context of that production set. A period of time is specified as well as the production [technologies](http://en.wikipedia.org/wiki/Technology). The commodity compared can either be a [good](http://en.wikipedia.org/wiki/Good_(economics)) or a [service](http://en.wikipedia.org/wiki/Service_(economics)).

PPFs are normally drawn as bulging upwards ("concave") from the origin but can also be represented as bulging downward or linear (straight), depending on a number of factors. A PPF can be used to represent a number of economic concepts, such as [scarcity](http://en.wikipedia.org/wiki/Scarcity) of resources (i.e., the [fundamental economic problem all societies face](http://en.wikipedia.org/wiki/Economic_problem)), [opportunity cost](http://en.wikipedia.org/wiki/Opportunity_cost) (or marginal rate of transformation), productive efficiency, [allocative efficiency](http://en.wikipedia.org/wiki/Allocative_efficiency), and [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale). In addition, an outward shift of the PPF results from growth of the availability of inputs such as physical capital or labour, or [technological progress](http://en.wikipedia.org/wiki/Technological_progress) in our knowledge of how to transform inputs into outputs. Such a shift allows [economic growth](http://en.wikipedia.org/wiki/Economic_growth) of an economy already operating at its full productivity (on the PPF), which means that more of *both* outputs can be produced during the specified period of time without sacrificing the output of either good. Conversely, the PPF will shift inward if the labour force shrinks, the supply of raw materials is depleted, or a natural disaster decreases the stock of physical capital. However, most economic contractions reflect not that less can be produced, but that the economy has started operating below the frontier—typically both labour and physical capital are underemployed. The combination represented by the point on the PPF where an economy operates shows the priorities or choices of the economy, such as the choice between producing more [capital goods](http://en.wikipedia.org/wiki/Capital_(economics)) and fewer [consumer goods](http://en.wikipedia.org/wiki/Consumer_good), or vice versa.

## Efficiency

[](http://en.wikipedia.org/wiki/File:Production_Possibilities_Frontier_Curve.svg)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Production_Possibilities_Frontier_Curve.svg)

An example PPF with illustrative points marked

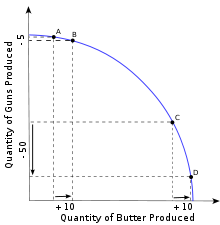
A PPF shows all possible combinations of two goods that can be produced simultaneously during a given period of time, [*ceteris paribus*](http://en.wikipedia.org/wiki/Ceteris_paribus). Commonly, it takes the form of the curve on the right. For an economy to increase the quantity of one good produced, production of the other good must be sacrificed. Here, butter production must be sacrificed in order to produce more guns. PPFs represent how much of the latter must be sacrificed for a given increase in production of the former.

Such a two-good world is a theoretical simplification, due to the difficulty of graphical analysis of multiple goods. If we are interested in one good, a composite score of the other goods can be generated using different techniques. Furthermore, the production model can be generalized using higher-dimensional techniques such as Principal Component Analysis (PCA) and others.

For example, assume that the supply of the economy's [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) does not change over time, in order to produce more butter, producing "guns" needs to be sacrificed. If production is efficient, the economy can choose between combinations (i.e. points) on the PPF: *B* if guns are of interest, *C* if more butter is needed, *D* if an equal mix of butter and guns is required.

In the PPF, all points *on* the curve are points of maximum [productive efficiency](http://en.wikipedia.org/wiki/Productive_efficiency) (i.e., no more output can be achieved from the given inputs); all points inside the frontier (such as *A*) can be produced but productively *inefficient*; all points outside the curve (such as *X*) cannot be produced with the given, existing resources. Not all points on the curve are [Pareto efficient](http://en.wikipedia.org/wiki/Pareto_efficient), however; only in the case where the [marginal rate of transformation](http://en.wikipedia.org/wiki/Production_possibilities_frontier#Marginal_rate_of_transformation) is equal to all consumers' [marginal rate of substitution](http://en.wikipedia.org/wiki/Marginal_rate_of_substitution) and hence equal to the ratio of prices will it be impossible to find any trade that will make no consumer worse off.

## Opportunity cost

[](http://en.wikipedia.org/wiki/File:PPF_opportunity_cost.svg)

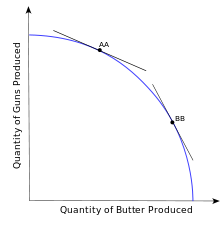
[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:PPF_opportunity_cost.svg)

Increasing butter from A to B carries little opportunity cost, but for C to D the cost is great.

If there is no increase in productive resources, increasing production of a first good entails decreasing production of a second, because resources must be transferred to the first and away from the second. Points along the curve describe the trade-off between the goods. The sacrifice in the production of the second good is called the *opportunity cost* (because increasing production of the first good entails losing the opportunity to produce some amount of the second). Opportunity cost is measured in the number of units of the second good forgone for one or more units of the first good.

In the context of a PPF, opportunity cost is directly related to the shape of the curve (see below). If the shape of the PPF curve is straight-line, the opportunity cost is constant as production of different goods is changing. But, opportunity cost usually will vary depending on the start and end point. In the diagram on the right, producing 10 more packets of butter, at a low level of butter production, costs the opportunity of 5 guns (as with a movement from *A* to *B*). At point C, the economy is already close to its maximum potential butter output. To produce 10 more packets of butter, 50 guns must be sacrificed (as with a movement from *C* to *D*). The ratio of opportunity costs is determined by the *marginal rate of transformation.*

## Marginal rate of transformation

[](http://en.wikipedia.org/wiki/File:PPF_marginal_rate_of_transformation.svg)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:PPF_marginal_rate_of_transformation.svg)

Marginal rate of transformation increases when the transition is made from AA to BB.

The slope of the production–possibility frontier (PPF) at any given point is called the marginal rate of transformation (**MRT**). The [slope](http://en.wikipedia.org/wiki/Slope) defines the rate at which [production](http://en.wikipedia.org/wiki/Manufacturing) of one good can be redirected (by re-allocation of production resources) into production of the other. It is also called the (marginal) "opportunity cost" of a commodity, that is, it is the opportunity cost of *X* in terms of *Y* at the margin. It measures how much of good Y is given up for one more unit of good X or vice versa. The shape of a PPF is commonly drawn as concave from the origin to represent increasing opportunity cost with increased output of a good. Thus, MRT increases in absolute size as one moves from the top left of the PPF to the bottom right of the PPF.

The marginal rate of transformation can be expressed in terms of either commodity. The marginal opportunity costs of guns in terms of butter are simply the reciprocal of the marginal opportunity cost of butter in terms of guns. If, for example, the (absolute) slope at point *BB* in the diagram is equal to 2, then, in order to produce one more packet of butter, the production of 2 guns must be sacrificed. If at *AA*, the marginal opportunity cost of butter in terms of guns is equal to 0.25, then, the sacrifice of one gun could produce four packets of butter, and the opportunity cost of guns in terms of butter is 4. Therefore Opportunity cost plays a major role in society,

## Shape

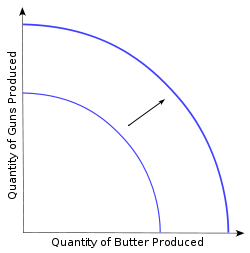
The production–possibility frontier can be constructed from the contract curve in an [Edgeworth production box](http://en.wikipedia.org/wiki/Edgeworth_box) diagram of factor intensity. The example used above (which demonstrates increasing opportunity costs, with a curve concave from the origin) is the most common form of PPF. It represents a disparity in the [factor](http://en.wikipedia.org/wiki/Heckscher-Ohlin_theorem) intensities and technologies of the two production sectors. That is, as an economy specializes more and more into one product (e.g., moving from point *B* to point *D*), the opportunity cost of producing that product increases, because we are using more and more resources that are less efficient in producing it. With increasing production of butter, workers from the gun industry will move to it. At first, the least qualified (or most general) gun workers will be transferred into making more butter, and moving these workers has little impact on the opportunity cost of increasing butter production: the loss in gun production will be small. But the cost of producing successive units of butter will increase as resources that are more and more specialized in gun production are moved into the butter industry.

If opportunity costs are constant, a straight-line (linear) PPF is produced.This case reflects a situation where resources are not specialized and can be substituted for each other with no added cost. Products requiring similar resources (bread and pastry, for instance) will have an almost straight PPF, hence almost constant opportunity costs. More specifically, with constant returns to scale, there are two opportunities for a linear PPF: firstly, if there was only one [factor of production](http://en.wikipedia.org/wiki/Factor_of_production) to consider, or secondly, if the factor intensity ratios in the two sectors were constant at all points on the production-possibilities curve. With varying returns to scale, however, it may not be entirely linear in either case.

With [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale), the PPF would appear inward, with opportunity costs falling as more are produced of each respective product. Specialization in producing successive units of a good determines its opportunity cost (say from [mass production](http://en.wikipedia.org/wiki/Mass_production) methods or [specialization of labour](http://en.wikipedia.org/wiki/Specialization_of_labor)).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| [http://upload.wikimedia.org/wikipedia/commons/thumb/4/4c/PPF_opportunity_cost.svg/250px-PPF_opportunity_cost.svg.png](http://en.wikipedia.org/wiki/File:PPF_opportunity_cost.svg) |  | [http://upload.wikimedia.org/wikipedia/commons/thumb/6/63/PPF_opportunity_cost_straight.svg/250px-PPF_opportunity_cost_straight.svg.png](http://en.wikipedia.org/wiki/File:PPF_opportunity_cost_straight.svg) |  | [http://upload.wikimedia.org/wikipedia/commons/thumb/9/9c/PPF_opportunity_cost_inverted.svg/250px-PPF_opportunity_cost_inverted.svg.png](http://en.wikipedia.org/wiki/File:PPF_opportunity_cost_inverted.svg) |
| A common PPF: increasing opportunity cost |  | A straight line PPF: constant opportunity cost |  | An inverted PPF: decreasing opportunity cost |

## Position

[](http://en.wikipedia.org/wiki/File:PPF_expansion.svg)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:PPF_expansion.svg)

An unbiased expansion in a PPF

The two main determinants of the position of the PPF at any given time are the state of [technology](http://en.wikipedia.org/wiki/Technology) and management expertise (which are reflected in the available [production functions](http://en.wikipedia.org/wiki/Production_function)) and the available quantities and [productivity](http://en.wikipedia.org/wiki/Productivity) of [factors of production](http://en.wikipedia.org/wiki/Factors_of_production). Only points on or within a PPF are actually possible to achieve in the short run. In the long run, if technology improves or if the productivity or supply of factors of production increases, the economy's capacity to produce both goods increases, i.e., [economic growth](http://en.wikipedia.org/wiki/Economic_growth) occurs. This increase is shown by a shift of the production-possibility frontier to the right. Conversely, a natural, military or ecological disaster might move the PPF to the left, in response to a reduction in an economy's productivity. Thus all points on or within the curve are part of the [production set](http://en.wikipedia.org/wiki/Production_set), i.e., combinations of goods that the economy could potentially produce.

If the two production goods depicted are [capital](http://en.wikipedia.org/wiki/Capital_(economics)) [investment](http://en.wikipedia.org/wiki/Investment#In_economics_or_macroeconomics) (to increase future production possibilities) or current consumption goods, the PPF can represent, how the higher investment this year, the more the PPF would shift out in following years. It can also represent how a technological progress that more favors production possibilities of one good, say Guns, shifts the PPF outwards more along the Gun axis, "biasing" production possibilities in that direction. Similarly, if one good makes more use of say capital and if capital grows faster than other factors, growth possibilities might be biased in favor of the capital-intensive good.

## Other applications

In [microeconomics](http://en.wikipedia.org/wiki/Microeconomics), the PPF shows the options open to an individual, [household](http://en.wikipedia.org/wiki/Household_production_function), or firm in a two-good world. By definition, each point on the curve is productively efficient, but, given the nature of [market demand](http://en.wikipedia.org/wiki/Supply_and_demand), some points will be more [profitable](http://en.wikipedia.org/wiki/Profit_(accounting)) than others. Equilibrium for a firm will be the combination of outputs on the PPF that is most profitable.

From a [macroeconomic](http://en.wikipedia.org/wiki/Macroeconomics) perspective, the PPF illustrates the production possibilities available to a nation or [economy](http://en.wikipedia.org/wiki/Economy) during a given period of time for broad categories of output. However, an economy may achieve [productive efficiency](http://en.wikipedia.org/wiki/Productive_efficiency) without necessarily being [allocatively efficient](http://en.wikipedia.org/wiki/Allocative_efficiency). Market failure (such as imperfect competition or externalities) and some institutions of social decision-making (such as government and tradition) may lead to the wrong combination of goods being produced (hence the wrong mix of resources being allocated between producing the two goods) compared to what consumers would prefer, given what is feasible on the PPF.

# III Macroeconomics

**Macroeconomics** is a branch of [economics](http://en.wikipedia.org/wiki/Economics) dealing with the performance, structure, behaviour, and decision-making of the whole [economy](http://en.wikipedia.org/wiki/Economy). This includes national, regional, and global economies. With [microeconomics](http://en.wikipedia.org/wiki/Microeconomics), macroeconomics is one of the two most general fields in [economics](http://en.wikipedia.org/wiki/Economics).

Macroeconomists study aggregated indicators such as [GDP](http://en.wikipedia.org/wiki/Gross_domestic_product), [unemployment rates](http://en.wikipedia.org/wiki/Unemployment#Measurement), and [price indices](http://en.wikipedia.org/wiki/Price_index) to understand how the whole economy functions. Macroeconomists develop models that explain the relationship between such factors as [national income](http://en.wikipedia.org/wiki/National_income), [output](http://en.wikipedia.org/wiki/Output_(economics)), [consumption](http://en.wikipedia.org/wiki/Consumption_(economics)), [unemployment](http://en.wikipedia.org/wiki/Unemployment), [inflation](http://en.wikipedia.org/wiki/Inflation), [savings](http://en.wikipedia.org/wiki/Savings), [investment](http://en.wikipedia.org/wiki/Investment), [international trade](http://en.wikipedia.org/wiki/International_trade) and [international finance](http://en.wikipedia.org/wiki/International_finance). In contrast, [microeconomics](http://en.wikipedia.org/wiki/Microeconomics) is primarily focused on the actions of individual agents, such as [firms](http://en.wikipedia.org/wiki/Business_entity) and consumers, and how their behaviour determines [prices](http://en.wikipedia.org/wiki/Prices) and quantities in specific markets. While macroeconomics is a broad field of study, there are two areas of research that are emblematic of the discipline: the attempt to understand the causes and consequences of [short-run](http://en.wikipedia.org/wiki/Short-run) fluctuations in national income (the [business cycle](http://en.wikipedia.org/wiki/Business_cycle)), and the attempt to understand the determinants of [long-run](http://en.wikipedia.org/wiki/Long-run) [economic growth](http://en.wikipedia.org/wiki/Economic_growth) (increases in national income). [Macroeconomic models](http://en.wikipedia.org/wiki/Macroeconomic_model) and their forecasts are used by both governments and large corporations to assist in the development and evaluation of [economic policy](http://en.wikipedia.org/wiki/Economic_policy) and business strategy.

## Basic macroeconomic concepts

Macroeconomics encompasses a variety of concepts and variables, but three are central topics for macroeconomic research. Macroeconomic theories usually relate the phenomena of output, unemployment, and inflation. Outside of macroeconomic theory, these topics are also extremely important to all economic agents including workers, consumers, and producers.

### Output and income

National [output](http://en.wikipedia.org/wiki/Output_(economics)) is the total value of everything a country produces in a given time period. Everything that is produced and sold generates income. Therefore, output and income are usually considered equivalent and the two terms are often used interchangeably. Output can be measured as total income, or, it can be viewed from the production side and measured as the total value of [final goods](http://en.wikipedia.org/wiki/Final_goods) and services or the sum of all [value added](http://en.wikipedia.org/wiki/Value_added) in the economy.Macroeconomic output is usually measured by [Gross Domestic Product](http://en.wikipedia.org/wiki/Gross_Domestic_Product) (GDP) or one of the other [national accounts](http://en.wikipedia.org/wiki/National_accounts). Economists interested in long-run increases in output study economic growth. Advances in technology, accumulation of machinery and other [capital](http://en.wikipedia.org/wiki/Capital_(economics)), and better education and [human capital](http://en.wikipedia.org/wiki/Human_capital) all lead to increased economic output overtime. However, output does not always increase consistently. [Business cycles](http://en.wikipedia.org/wiki/Business_cycles) can cause short-term drops in output called [recessions](http://en.wikipedia.org/wiki/Recessions). Economists look for [macroeconomic policies](http://en.wikipedia.org/wiki/Macroeconomic_policies) that prevent economies from slipping into recessions and that lead to faster long-term growth.

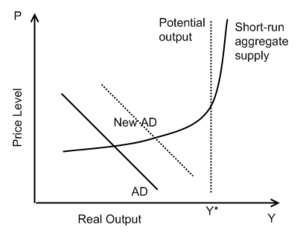
## Aggregate demand

In [macroeconomics](http://en.wikipedia.org/wiki/Macroeconomics), **aggregate demand** (**AD**) is the total demand for final goods and services in the economy (Y) at a given time and [price level](http://en.wikipedia.org/wiki/Price_level).It is the amount of goods and services in the economy that will be purchased at all possible price levels. This is the demand for the [gross domestic product](http://en.wikipedia.org/wiki/Gross_domestic_product) of a country when [inventory](http://en.wikipedia.org/wiki/Inventory) levels are static. It is often called [effective demand](http://en.wikipedia.org/wiki/Effective_demand), though at other times this term is distinguished.

It is often cited that the aggregate demand curve is downward sloping because at lower price levels a greater quantity is demanded. While this is correct at the microeconomic, single good level, at the aggregate level this is incorrect. The aggregate demand curve is in fact downward sloping as a result of three distinct effects: [Pigou's wealth effect](http://en.wikipedia.org/wiki/Pigou_effect), [the Keynes' interest rate effect](http://en.wikipedia.org/wiki/Keynes_effect) and the [Mundell-Fleming exchange-rate effect](http://en.wikipedia.org/wiki/Mundell%E2%80%93Fleming_model).

The **AD-AS** or **Aggregate Demand-Aggregate Supply model** is a [macroeconomic model](http://en.wikipedia.org/wiki/Macroeconomic_model) that explains [price level](http://en.wikipedia.org/wiki/Price_level) and [output](http://en.wikipedia.org/wiki/Output_(economics)) through the relationship of [aggregate demand](http://en.wikipedia.org/wiki/Aggregate_demand) and [aggregate supply](http://en.wikipedia.org/wiki/Aggregate_supply). It is based on the theory of [John Maynard Keynes](http://en.wikipedia.org/wiki/John_Maynard_Keynes) presented in his work [*The General Theory of Employment, Interest, and Money*](http://en.wikipedia.org/wiki/The_General_Theory_of_Employment,_Interest,_and_Money). It is one of the primary simplified representations in the modern field of [macroeconomics](http://en.wikipedia.org/wiki/Macroeconomics), and is used by a broad array of economists, from [libertarian](http://en.wikipedia.org/wiki/Libertarianism), [Monetarist](http://en.wikipedia.org/wiki/Monetarist) supporters of [laissez-faire](http://en.wikipedia.org/wiki/Laissez-faire), such as [Milton Friedman](http://en.wikipedia.org/wiki/Milton_Friedman) to [Post-Keynesian](http://en.wikipedia.org/wiki/Post-Keynesian_economics) supporters of [economic interventionism](http://en.wikipedia.org/wiki/Economic_interventionism), such as [Joan Robinson](http://en.wikipedia.org/wiki/Joan_Robinson).

The conventional "aggregate supply and demand" model is, in actuality, a Keynesian visualization that has come to be a widely accepted image of the theory. The Classical supply and demand model, which is largely based on [Say's Law](http://en.wikipedia.org/wiki/Say%27s_Law), or that supply creates its own demand, depicts the aggregate supply curve as being vertical at all times (not just in the long-run)



Aggregate supply/demand graph

## Macroeconomic policies

To try to avoid major economic shocks, such as [The Great Depression](http://en.wikipedia.org/wiki/The_Great_Depression), governments make adjustments through policy changes they hope will stabilize the economy. Governments believe the success of these adjustments is necessary to maintain stability and continue growth. This economic management is achieved through two types of governmental strategies:

## Fiscal policy

In [economics](http://en.wikipedia.org/wiki/Economics) and [political science](http://en.wikipedia.org/wiki/Political_science), **fiscal policy** is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy.[[1]](http://en.wikipedia.org/wiki/Fiscal_policy#cite_note-0) The two main instruments of fiscal policy are government taxation and expenditure. Changes in the level and composition of taxation and government spending can impact the following variables in the economy:

* [Aggregate demand](http://en.wikipedia.org/wiki/Aggregate_demand) and the level of economic activity;
* The pattern of resource allocation;
* The distribution of income.

Fiscal policy refers to the use of the government budget to influence economic activity.

## Monetary policy

**Monetary policy** is the process by which the [monetary authority](http://en.wikipedia.org/wiki/Monetary_authority) of a country controls the [supply of money](http://en.wikipedia.org/wiki/Supply_of_money), often targeting a rate of [interest](http://en.wikipedia.org/wiki/Interest) for the purpose of promoting [economic](http://en.wikipedia.org/wiki/Economy) growth and stability.The official goals usually include relatively stable prices and low [unemployment](http://en.wikipedia.org/wiki/Unemployment). [Monetary theory](http://en.wikipedia.org/wiki/Monetary_economics) provides insight into how to craft optimal monetary policy. It is referred to as either being [expansionary](http://en.wikipedia.org/wiki/Expansionary_monetary_policy) or [contractionary](http://en.wikipedia.org/wiki/Contractionary_monetary_policy), where an expansionary policy increases the total supply of money in the economy more rapidly than usual, and contractionary policy expands the money supply more slowly than usual or even shrinks it. Expansionary policy is traditionally used to try to combat [unemployment](http://en.wikipedia.org/wiki/Unemployment) in a [recession](http://en.wikipedia.org/wiki/Recession) by lowering [interest rates](http://en.wikipedia.org/wiki/Interest_rates) in the hope that easy credit will entice businesses into expanding. Contractionary policy is intended to slow [inflation](http://en.wikipedia.org/wiki/Inflation) in hopes of avoiding the resulting distortions and deterioration of asset values.

Monetary policy differs from [fiscal policy](http://en.wikipedia.org/wiki/Fiscal_policy), which refers to [taxation](http://en.wikipedia.org/wiki/Tax), [government spending](http://en.wikipedia.org/wiki/Government_spending), and [associated borrowing](http://en.wikipedia.org/wiki/Government_borrowing).

## Unemployment

The amount of unemployment in an economy is measured by the unemployment rate, the percentage of workers without jobs in the [labour force](http://en.wikipedia.org/wiki/Labor_force). The labour force only includes workers actively looking for jobs. People who are retired, pursuing education, or [discouraged from seeking work](http://en.wikipedia.org/wiki/Discouraged_worker) by a lack of job prospects are excluded from the labour force.

Unemployment can be generally broken down into several types that are related to different causes. Classical unemployment occurs when wages are too high for employers to be willing to hire more workers. Wages may be too high because of minimum wage laws or union activity. Consistent with classical unemployment, frictional unemployment occurs when appropriate job vacancies exist for a worker, but the length of time needed to search for and find the job leads to a period of unemployment.Structural unemployment covers a variety of possible causes of unemployment including a mismatch between workers' skills and the skills required for open jobs.Large amounts of structural unemployment can occur when an economy is transitioning industries and workers find their previous sets of skills are no longer in demand. Structural unemployment is similar to frictional unemployment since both reflect the problem of matching workers with job vacancies, but structural unemployment covers the time needed to acquire new skills not just the short term search process.[ While some types of unemployment may occur regardless of the condition of the economy, cyclical unemployment occurs when growth stagnates. [Okun's law](http://en.wikipedia.org/wiki/Okun%27s_law) represents the empirical relationship between unemployment and economic growth. The original version of Okun's law states that a 3% increase in output would lead to a 1% decrease in unemployment.

## Inflation and deflation

A general price increase across the entire economy is called [inflation](http://en.wikipedia.org/wiki/Inflation). When prices decrease, there is [deflation](http://en.wikipedia.org/wiki/Deflation). Economists measure these changes in prices with [price indexes](http://en.wikipedia.org/wiki/Price_indexes). Inflation can occur when an economy becomes overheated and grows too quickly. Similarly, a declining economy can lead to deflation. [Central bankers](http://en.wikipedia.org/wiki/Central_bank), who control a country's money supply, try to avoid changes in price level by using [monetary policy](http://en.wikipedia.org/wiki/Monetary_policy). Raising interest rates or reducing the supply of money in an economy will reduce inflation. Inflation can lead to increased uncertainty and other negative consequences. Deflation can lower economic output. Central bankers try to stabilize prices to protect economies from the negative consequences of price changes.

Changes in price level may be result of several factors. The [quantity theory of money](http://en.wikipedia.org/wiki/Quantity_theory_of_money) holds that changes in price level are directly related to changes in the [money supply](http://en.wikipedia.org/wiki/Money_supply). Most economists believe that this relationship explains long-run changes in the price level. Short-run fluctuations may also be related to monetary factors, but changes in aggregate demand and aggregate supply can also influence price level. For example, a decrease in demand because of a recession can lead to lower price levels and deflation. A negative supply shock, like an oil crisis, lowers aggregate supply and can cause inflation.

## Diminishing returns

In [economics](http://en.wikipedia.org/wiki/Economics), diminishing returns (also called diminishing marginal returns) is the decrease in the [marginal](http://en.wikipedia.org/wiki/Marginalism) (per-unit) output of a [production](http://en.wikipedia.org/wiki/Production_(economics)) process as the amount of a single [factor of production](http://en.wikipedia.org/wiki/Factors_of_production) is increased, while the amounts of all other factors of production stay constant.

The law of diminishing returns (also law of diminishing marginal returns or law of increasing relative cost) states that in all productive processes, adding more of one factor of production, while holding all others constant, will at some point yield lower per-unit returns. The law of diminishing returns does not imply that adding more of a factor will decrease the *total* production, a condition known as negative returns, though in fact this is common.

For example, the use of [fertilizer](http://en.wikipedia.org/wiki/Fertilizer) improves crop production on farms and in gardens; but at some point, adding more and more fertilizer improves the yield less per unit of fertilizer, and excessive quantities can even reduce the yield. A common sort of example is adding more workers to a job, such as assembling a car on a [factory floor](http://en.wikipedia.org/wiki/Shop_floor). At some point, adding more workers causes problems such as getting in each other's way, or workers frequently find themselves waiting for access to a part. In all of these processes, producing one more unit of output per unit of time will eventually cost increasingly more, due to inputs being used less and less effectively.

The law of diminishing returns is a fundamental principle of economics.It plays a central role in [production theory](http://en.wikipedia.org/wiki/Production_theory_basics).

## Gross domestic product (GDP)

Gross domestic product (GDP) refers to the [market value](http://en.wikipedia.org/wiki/Market_value) of all officially recognized final goods and services produced within a country in a given period. GDP [per capita](http://en.wikipedia.org/wiki/Per_capita) is often considered an indicator of a country's [standard of living](http://en.wikipedia.org/wiki/Standard_of_living); GDP per capita is not a measure of personal income. See [Standard of living and GDP](http://en.wikipedia.org/wiki/Gross_domestic_product#Standard_of_living_and_GDP). Under economic theory, GDP per capita exactly equals the gross domestic income (GDI) per capita.

The **GDP (PPP) per hour worked** is a measure of the [productivity](http://en.wikipedia.org/wiki/Productivity) of a country when not taking into account unemployment or hours worked per week. GDP (PPP) stands for [gross domestic product](http://en.wikipedia.org/wiki/Gross_domestic_product) normalized to [purchasing power parities](http://en.wikipedia.org/wiki/Purchasing_power_parity).

## Gross domestic income (GDI)

The *e'* (GDI) is the total income received by all sectors of an economy within a nation. It includes the sum of all wages, profits, and minus subsidies. Since all income is derived from production (including the production of services), the gross domestic income of a country should exactly equal its [gross domestic product](http://en.wikipedia.org/wiki/Gross_domestic_product) (GDP). The GDP is a very commonly cited statistic measuring the economic activity of countries, and the GDI is quite uncommon.

## Gross National Product (GNP)

**Gross National Product (GNP)** is the market value of all products and services produced in one year by labour and property supplied by the residents of a country. Unlike [Gross Domestic Product](http://en.wikipedia.org/wiki/Gross_Domestic_Product) (GDP), which defines production based on the geographical location of production, GNP allocates production based on ownership.

GNP does not distinguish between qualitative improvements in the state of the technical arts (e.g., increasing computer processing speeds), and quantitative increases in goods (e.g., number of computers produced), and considers both to be forms of "economic growth".

## GDP vs. GNP

GDP can be contrasted with [gross national product](http://en.wikipedia.org/wiki/Gross_national_product) (GNP) or [gross national income](http://en.wikipedia.org/wiki/Gross_National_Income) (GNI). The difference is that GDP defines its scope according to location, while GNP defines its scope according to ownership. In a global context, [world GDP and world GNP](http://en.wikipedia.org/wiki/Gross_world_product) are, therefore, equivalent terms.

GDP is product produced within a country's borders; GNP is product produced by enterprises owned by a country's citizens. The two would be the same if all of the productive enterprises in a country were owned by its own citizens, and those citizens did not own productive enterprises in any other countries. In practice, however, foreign ownership makes GDP and GNP non-identical. Production within a country's borders, but by an enterprise owned by somebody outside the country, counts as part of its GDP but not its GNP; on the other hand, production by an enterprise located outside the country, but owned by one of its citizens, counts as part of its GNP but not its GDP.

To take the United States as an example, the U.S.'s GNP is the value of output produced by American-owned firms, regardless of where the firms are located. Similarly, if a country becomes increasingly in debt, and spends large amounts of income servicing this debt this will be reflected in a decreased GNI but not a decreased GDP. Similarly, if a country sells off its resources to entities outside their country this will also be reflected over time in decreased GNI, but not decreased GDP. This would make the use of GDP more attractive for politicians in countries with increasing national debt and decreasing assets.

Gross national income (GNI) equals GDP plus income receipts from the rest of the world minus income payments to the rest of the world.

## Recession

In economics, a **recession** is a [business cycle](http://en.wikipedia.org/wiki/Business_cycle) contraction, a general slowdown in economic activity.[Macroeconomic](http://en.wikipedia.org/wiki/Macroeconomics) indicators such as GDP, employment, investment spending, [capacity utilization](http://en.wikipedia.org/wiki/Capacity_utilization), household income, business profits, and inflation fall, while bankruptcies and the [unemployment rate](http://en.wikipedia.org/wiki/Unemployment_rate) rise.

Recessions generally occur when there is a widespread drop in spending, often following an adverse [supply shock](http://en.wikipedia.org/wiki/Supply_shock) or the bursting of an [economic bubble](http://en.wikipedia.org/wiki/Economic_bubble). Governments usually respond to recessions by adopting expansionary [macroeconomic policies](http://en.wikipedia.org/wiki/Macroeconomic_policies), such as [increasing money supply](http://en.wikipedia.org/wiki/Monetary_policy), [increasing government spending and decreasing taxation](http://en.wikipedia.org/wiki/Fiscal_policy).

## Marginal product

In [economics](http://en.wikipedia.org/wiki/Economics) and in particular [neoclassical economics](http://en.wikipedia.org/wiki/Neoclassical_economics), the **marginal product** or **marginal physical product** of an input ([factor of production](http://en.wikipedia.org/wiki/Factor_of_production)) is the extra output that can be produced by using one more unit of the input (for instance, the difference in output when a firm's labour usage is increased from five to six units), assuming that the quantities of no other inputs to production change. The marginal product of a given input can be expressed as

MP =  \frac{\Delta Y}{\Delta X}

Where \Delta X is the change in the firm's use of the input (conventionally a one-unit change) and \Delta Y is the change in quantity of output produced. Note that the quantity Y of the "product" is typically defined ignoring [external costs and benefits](http://en.wikipedia.org/wiki/Externalities).

If the output and the input are infinitely divisible, so the marginal "units" are infinitesimal, the marginal product is the mathematical [derivative](http://en.wikipedia.org/wiki/Derivative) of the [production function](http://en.wikipedia.org/wiki/Production_function) with respect to that input. Suppose a firm's output *Y* is given by the production function Y=F(K,L) where *K* and *L* are inputs to production (say, capital and labour). Then the marginal product of capital (*MPK*) and marginal product of labour (*MPL*) are given by:

MPK=\frac{\partial F}{\partial K}

MPL=\frac{\partial F}{\partial L}

In the "law" of [diminishing marginal returns](http://en.wikipedia.org/wiki/Diminishing_returns), the marginal product of one input is assumed to fall as one considers higher and higher starting points for the quantity of that input. The marginal product of labour is the slope of the [total product](http://en.wikipedia.org/wiki/Total_product) curve, which is the production function plotted against labour usage for a fixed level of usage of the capital input.

In the neoclassical theory of [competitive markets](http://en.wikipedia.org/wiki/Perfect_competition), the [marginal product of labour](http://en.wikipedia.org/wiki/Marginal_product_of_labor) equals the [real](http://en.wikipedia.org/wiki/Real_vs._nominal_in_economics) wage. In aggregate models of perfect competition, in which a single good is produced and that good is used both in consumption and as a capital good, the [marginal product of capital](http://en.wikipedia.org/wiki/Marginal_product_of_capital) equals its [rate of return](http://en.wikipedia.org/wiki/Rate_of_profit). As was shown in the [Cambridge capital controversy](http://en.wikipedia.org/wiki/Cambridge_capital_controversy), this proposition about the marginal product of capital cannot generally be sustained in multi commodity models in which capital and consumption goods are distinguished.

## Marginal cost

In [economics](http://en.wikipedia.org/wiki/Economics) and [finance](http://en.wikipedia.org/wiki/Finance), **marginal cost** is the change in [total cost](http://en.wikipedia.org/wiki/Total_cost) that arises when the quantity produced changes by one unit. That is, it is the cost of producing one more unit of a good.[[1]](http://en.wikipedia.org/wiki/Marginal_cost#cite_note-0) If the good being produced is infinitely divisible, so the size of a marginal cost will change with volume, as a non-linear and non-proportional cost function includes the following:

* variable terms dependent to volume,
* constant terms independent to volume and occurring with the respective lot size,
* jump fix cost increase or decrease dependent to steps of volume increase.

In practice the above definition of marginal cost as the change in total cost as a result of an increase in output of one unit is inconsistent with the calculation of marginal cost as MC=dTC/dQ for virtually all non-linear functions. This is as the definition MC=dTC/dQ finds the tangent to the total cost curve at the point q which assumes that costs increase at the same rate as they were at q. A new definition may be useful for marginal unit cost (MUC) using the current definition of the change in total cost as a result of an increase of one unit of output defined as: TC(q+1)-TC(q) and re-defining marginal cost to be the change in total as a result of an infinitesimally small increase in q which is consistent with its use in economic literature and can be calculated as dTC/dQ.

In general terms, marginal cost at each level of production includes any additional costs required to produce the next unit. If producing additional vehicles requires, for example, building a new factory, the marginal cost of those *extra* vehicles includes the cost of the new factory. In practice, the analysis is segregated into short and long-run cases, and over the longest run, all costs are marginal. At each level of production and time period being considered, marginal costs include all costs that vary with the level of production, and other costs are considered fixed costs.

If the cost function is differentiable joining, the marginal cost is the cost of the next unit produced referring to the basic volume.

MC=\frac{dTC}{dQ}

If the cost function is not differentiable, the marginal cost can be expressed as follows.

MC=\frac{\Delta TC}{\Delta Q}

A number of other factors can affect marginal cost and its applicability to real world problems. Some of these may be considered market failures. These may include [information asymmetries](http://en.wikipedia.org/wiki/Information_asymmetry), the presence of negative or positive [externalities](http://en.wikipedia.org/wiki/Externality), [transaction costs](http://en.wikipedia.org/wiki/Transaction_costs), [price discrimination](http://en.wikipedia.org/wiki/Price_discrimination) and others.

## Economies of scale

Economies of scale is a concept that applies to the long run, a span of time in which all inputs can be varied by the firm so that there are no fixed inputs or fixed costs. Production may be subject to [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale) (or [diseconomies of scale](http://en.wikipedia.org/wiki/Diseconomies_of_scale)). Economies of scale are said to exist if an additional unit of output can be produced for less than the average of all previous units— that is, if long-run marginal cost is below long-run average cost, so the latter is falling. Conversely, there may be levels of production where marginal cost is higher than average cost, and average cost is an increasing function of output. For this generic case, minimum average cost occurs at the point where average cost and marginal cost are equal (when plotted, the marginal cost curve intersects the average cost curve from below); this point will *not* be at the minimum for marginal cost if fixed costs are greater than zero.

## Aggregation problem

An *aggregate* in [economics](http://en.wikipedia.org/wiki/Economics) is a summary measure describing a market or economy. The **aggregation problem** refers to the difficulty of treating an [empirical](http://en.wikipedia.org/wiki/Empirical) or theoretical aggregate as if it reacted like a less-aggregated measure, say, about behaviour of an individual [agent](http://en.wikipedia.org/wiki/Agent_(economics)) as described in general [microeconomic theory](http://en.wikipedia.org/wiki/Microeconomic_theory).Examples of aggregates in micro- and [macroeconomics](http://en.wikipedia.org/wiki/Macroeconomics) relative to less aggregated counterparts are:

* food vs. apples
* the [price level](http://en.wikipedia.org/wiki/Price_level) and [real GDP](http://en.wikipedia.org/wiki/Real_GDP) vs. the price and quantity of apples
* the [capital stock](http://en.wikipedia.org/wiki/Capital_stock) for the economy vs. the value of computers of a certain type and the value of [steam shovels](http://en.wikipedia.org/wiki/Steam_shovel)
* the [money supply](http://en.wikipedia.org/wiki/Money_supply) vs. paper currency
* the general [unemployment rate](http://en.wikipedia.org/wiki/Unemployment_rate#Measuring_unemployment) vs. the unemployment rate of civil engineers.

Standard theory uses simple assumptions to derive general, and commonly accepted, results such as the [law of demand](http://en.wikipedia.org/wiki/Law_of_demand) to explain market behaviour. An example is the abstraction of a [composite good](http://en.wikipedia.org/wiki/Composite_good). It considers the price of one good changing proportionately to the composite good, that is, all other goods. If this assumption is violated and the agents are subject to aggregated [utility functions](http://en.wikipedia.org/wiki/Utility_function), restrictions on the latter are necessary to yield the law of demand. The aggregation problem emphasizes:

* how broad such restrictions are in microeconomics
* that use of broad factor inputs ('labour' and 'capital'), real 'output', and 'investment', as if there was only a single such aggregate is without a solid foundation for rigorously deriving analytical results.

[Franklin Fisher](http://en.wikipedia.org/wiki/Franklin_Fisher) notes that this has not dissuaded macroeconomists from continuing to use such concepts.

## Trade

**Trade** is the transfer of [ownership](http://en.wikipedia.org/wiki/Ownership) of goods and services from one person or entity to another by getting something in exchange from the [buyer](http://en.wikipedia.org/wiki/Buyer). Trade is sometimes loosely called [commerce](http://en.wikipedia.org/wiki/Commerce) or [financial transaction](http://en.wikipedia.org/wiki/Financial_transaction) or barter. A network that allows trade is called a [market](http://en.wikipedia.org/wiki/Market). The original form of trade was [barter](http://en.wikipedia.org/wiki/Barter_(economics)), the direct exchange of goods and services. Later one side of the barter were the metals, precious metals (poles, coins), bill, paper money. Modern traders instead generally negotiate through a medium of exchange, such as [money](http://en.wikipedia.org/wiki/Money). As a result, **buying** can be separated from **selling**, or [earning](http://en.wikipedia.org/wiki/Earning). The invention of money (and later credit, paper money and non-physical money) greatly simplified and promoted trade. Trade between two traders is called bilateral trade, while trade between more than two traders is called multilateral trade.

Trade exists for man due to specialization and division of labour, most people concentrate on a small aspect of production, trading for other products. Trade exists between regions because different regions have a [comparative advantage](http://en.wikipedia.org/wiki/Comparative_advantage) in the production of some tradable commodity, or because different regions' size allows for the benefits of [mass production](http://en.wikipedia.org/wiki/Mass_production). As such, trade at [market prices](http://en.wikipedia.org/wiki/Market_price) between locations benefits both locations.

[Retail](http://en.wikipedia.org/wiki/Retail) trade consists of the [sale](http://en.wikipedia.org/wiki/Sales) of goods or merchandise from a very fixed location, such as a [department store](http://en.wikipedia.org/wiki/Department_store), [boutique](http://en.wikipedia.org/wiki/Boutique) or [kiosk](http://en.wikipedia.org/wiki/Kiosk), or by [mail](http://en.wikipedia.org/wiki/Mail), in small or individual lots for direct [consumption](http://en.wikipedia.org/wiki/Consumption_(economics)) by the purchaser.[Wholesale](http://en.wikipedia.org/wiki/Wholesale) trade is defined as the sale of goods or [merchandise](http://en.wikipedia.org/wiki/Merchandise) to [retailers](http://en.wikipedia.org/wiki/Retailer), to industrial, commercial, institutional, or other professional [business](http://en.wikipedia.org/wiki/Business) users, or to other wholesalers and related subordinated services.

Trading can also refer to the action performed by [traders](http://en.wikipedia.org/wiki/Trader_(finance)) and other market agents in the [financial markets](http://en.wikipedia.org/wiki/Financial_markets).

## Currency

In [economics](http://en.wikipedia.org/wiki/Economics), **currency** refers to a generally accepted [medium of exchange](http://en.wikipedia.org/wiki/Medium_of_exchange). These are usually the [coins](http://en.wikipedia.org/wiki/Coins) and [banknotes](http://en.wikipedia.org/wiki/Banknotes) of a particular government, which comprise the physical aspects of a nation's [money supply](http://en.wikipedia.org/wiki/Money_supply). The other part of a nation's money supply consists of [bank deposits](http://en.wikipedia.org/wiki/Bank_deposits) (sometimes called [deposit money](http://en.wikipedia.org/wiki/Deposit_money)), ownership of which can be transferred by means of [cheques](http://en.wikipedia.org/wiki/Cheque), [debit cards](http://en.wikipedia.org/wiki/Debit_card), or other forms of money transfer. Deposit money and currency are [money](http://en.wikipedia.org/wiki/Money) in the sense that both are acceptable as a means of payment.

Direct exchange of [commodities](http://en.wikipedia.org/wiki/Commodity_money) such as precious metals, furs, grain, etc. in early human [societies](http://en.wikipedia.org/wiki/Society) lead to the first money proper in early civilizations. Until modern times, precious metals such as [gold](http://en.wikipedia.org/wiki/Gold) or [silver](http://en.wikipedia.org/wiki/Silver) typically were used to retain the commodity nature of the store of value function of money. However, nearly all contemporary monetary systems are based on [fiat money](http://en.wikipedia.org/wiki/Fiat_money). Usually, a government declares its currency (including notes and coins issued by the [central bank](http://en.wikipedia.org/wiki/Central_bank)) to be [legal tender](http://en.wikipedia.org/wiki/Legal_tender), making it unlawful to not accept it as a means of repayment for all debts, public and private. In major modern economies such as those of the United States or the Euro Zone, most money is electronic, but the "currency" of these polities may, depending on context, include all money or just [specie](http://en.wikipedia.org/wiki/Specie).

# IV Organization of Industries

## Monopoly

A **monopoly**  exists when a specific person or enterprise is the only supplier of a particular commodity (this contrasts with a [monopsony](http://en.wikipedia.org/wiki/Monopsony) which relates to a single entity's control of a [market](http://en.wikipedia.org/wiki/Market) to purchase a good or service, and with [oligopoly](http://en.wikipedia.org/wiki/Oligopoly) which consists of a few entities dominating an [industry](http://en.wikipedia.org/wiki/Industry))Monopolies are thus characterized by a lack of economic [competition](http://en.wikipedia.org/wiki/Competition) to produce the [good](http://en.wikipedia.org/wiki/Good_(economics)) or [service](http://en.wikipedia.org/wiki/Service_(economics)) and a lack of viable [substitute goods](http://en.wikipedia.org/wiki/Substitute_good). The verb "monopolize" refers to the *process* by which a company gains the ability to raise prices or exclude competitors. In economics, a monopoly is a single seller. In law, a monopoly is business entity that has significant market power, that is, the power, to charge high prices.Although monopolies may be big businesses, size is not a characteristic of a monopoly. A small business may still have the power to raise prices in a small industry (or market).

A monopoly is distinguished from a monopsony, in which there is only one *buyer* of a product or service; a monopoly may also have monopsony control of a sector of a market. Likewise, a monopoly should be distinguished from a [cartel](http://en.wikipedia.org/wiki/Cartel) (a form of oligopoly), in which several providers act together to coordinate services, prices or sale of goods. Monopolies, monopsonies and oligopolies are all situations such that one or a few of the entities have [market power](http://en.wikipedia.org/wiki/Market_power) and therefore interact with their customers (monopoly), suppliers (monopsony) and the other companies (oligopoly) in a [game theoretic](http://en.wikipedia.org/wiki/Game_theory) manner – meaning that expectations about their behaviour affects other players' choice of strategy and vice versa. This is to be contrasted with the model of [perfect competition](http://en.wikipedia.org/wiki/Perfect_competition) in which companies are "[price takers](http://en.wikipedia.org/wiki/Price_takers)" and do not have market power.

When not coerced legally to do otherwise, monopolies typically maximize their profit by producing fewer goods and selling them at higher prices than would be the case for perfect competition. (See also [Bertrand](http://en.wikipedia.org/wiki/Bertrand_competition), [Cournot](http://en.wikipedia.org/wiki/Cournot_competition) or [Stackelberg](http://en.wikipedia.org/wiki/Stackelberg_competition) equilibria, market power, [market share](http://en.wikipedia.org/wiki/Market_share), [market concentration](http://en.wikipedia.org/wiki/Market_concentration), [Monopoly profit](http://en.wikipedia.org/wiki/Monopoly_profit), [industrial economics](http://en.wikipedia.org/wiki/Industrial_economics)). Sometimes governments decide legally that a given company is a monopoly that doesn't serve the best interests of the market and/or consumers. Governments may force such companies to divide into smaller independent corporations as was the case of [United States v. AT&T](http://en.wikipedia.org/wiki/United_States_v._AT%26T), or alter its behaviour as was the case of [United States v. Microsoft](http://en.wikipedia.org/wiki/United_States_v._Microsoft), to protect consumers.

Monopolies can be established by a government, form [naturally](http://en.wikipedia.org/wiki/Natural_monopoly), or form by mergers. A monopoly is said to be [coercive](http://en.wikipedia.org/wiki/Coercive_monopoly) when the monopoly actively prohibits competitors by using practices (such as underselling) which derive from its market or political influence (see [Chainstore paradox](http://en.wikipedia.org/wiki/Chainstore_paradox)). There is often debate of whether market restrictions are in the best long-term interest of present and future consumers.

In many jurisdictions, [competition laws](http://en.wikipedia.org/wiki/Competition_law) restrict monopolies. Holding a dominant position or a monopoly of a market is not illegal in it, however certain categories of behaviour can, when a business is dominant, be considered abusive and therefore incur legal sanctions. A [government-granted monopoly](http://en.wikipedia.org/wiki/Government-granted_monopoly) or *legal monopoly*, by contrast, is sanctioned by the state, often to provide an incentive to invest in a risky venture or enrich a domestic [interest group](http://en.wikipedia.org/wiki/Advocacy_group). [Patents](http://en.wikipedia.org/wiki/Patent), [copyright](http://en.wikipedia.org/wiki/Copyright), and [trademarks](http://en.wikipedia.org/wiki/Trademark) are sometimes used as examples of government granted monopolies, but they rarely provide market power. The government may also reserve the venture for itself, thus forming a [government monopoly](http://en.wikipedia.org/wiki/Government_monopoly).

## Market structures

In economics, the idea of monopoly is important for the study of [market structures](http://en.wikipedia.org/wiki/Market_structure), which directly concerns normative aspects of economic competition, and provides the basis for topics such as [industrial organization](http://en.wikipedia.org/wiki/Industrial_organization) and [economics of regulation](http://en.wikipedia.org/wiki/Regulatory_economics). There are four basic types of market structures by traditional economic analysis: perfect competition, monopolistic competition, oligopoly and monopoly. A monopoly is a market structure in which a single supplier produces and sells a given product. If there is a single seller in a certain industry and there are not any close substitutes for the product, then the market structure is that of a "pure monopoly". Sometimes, there are many sellers in an industry and/or there exist many close substitutes for the goods being produced, but nevertheless companies retain some market power. This is termed [monopolistic competition](http://en.wikipedia.org/wiki/Monopolistic_competition), whereas by oligopoly the companies interact strategically.

In general, the main results from this theory compare price-fixing methods across market structures, analyze the effect of a certain structure on welfare, and vary technological/demand assumptions in order to assess the consequences for an abstract model of society. Most economic textbooks follow the practice of carefully explaining the *perfect competition* model, only because of its usefulness to understand "departures" from it (the so-called *imperfect competition* models).

The boundaries of what constitutes a market and what doesn't are relevant distinctions to make in economic analysis. In a general equilibrium context, a good is a specific concept entangling geographical and time-related characteristics. Most studies of market structure relax a little their definition of a good, allowing for more flexibility at the identification of substitute-goods. Therefore, one can find an economic analysis of the market of *grapes in Russia*, for example, which is not a market in the strict sense of general equilibrium theory monopoly.

## Characteristics

* **Profit Maximiser**: Maximizes profits.
* **Price Maker**: Decides the price of the good or product to be sold.
* **High Barriers to Entry**: Other sellers are unable to enter the market of the monopoly.
* **Single seller:** In a monopoly there is one seller of the good which produces all the output. Therefore, the whole market is being served by a single company, and for practical purposes, the company is the same as the industry.
* **Price Discrimination**: A monopolist can change the price and quality of the product. He sells more quantities charging fewer prices for the product in a very elastic market and sells less quantities charging high price in a less elastic market.

## Sources of monopoly power

Monopolies derive their market power from barriers to entry – circumstances that prevent or greatly impede a potential competitor's ability to compete in a market. There are three major types of barriers to entry; economic, legal and deliberate.

* **Economic barriers**: Economic barriers include economies of scale, capital requirements, cost advantages and technological superiority.

**Economies of scale**: Monopolies are characterized by decreasing costs for a relatively large range of production.Decreasing costs coupled with large initial costs give monopolies an advantage over would-be competitors. Monopolies are often in a position to reduce prices below a new entrant's operating costs and thereby prevent them from continuing to compete.  Furthermore, the size of the industry relative to the [minimum efficient scale](http://en.wikipedia.org/wiki/Minimum_efficient_scale) may limit the number of companies that can effectively compete within the industry. If for example the industry is large enough to support one company of minimum efficient scale then other companies entering the industry will operate at a size that is less than MES, meaning that these companies cannot produce at an average cost that is competitive with the dominant company. Finally, if long-term average cost is constantly decreasing, the least cost method to provide a good or service is by a single company.

**Capital requirements**: Production processes that require large investments of capital, or large research and development costs or substantial sunk costs limit the number of companies in an industry.Large fixed costs also make it difficult for a small company to enter an industry and expand.

**Technological superiority**: A monopoly may be better able to acquire, integrate and use the best possible technology in producing its goods while entrants do not have the size or finances to use the best available technology.One large company can sometimes produce goods cheaper than several small companies.

**No substitute goods:** A monopoly sells a good for which there is no close substitute. The absence of substitutes makes the demand for the good relatively inelastic enabling monopolies to extract positive profits.

**Control of natural resources**: A prime source of monopoly power is the control of resources that are critical to the production of a final good.

**Network externalities**: The use of a product by a person can affect the value of that product to other people. This is the network effect. There is a direct relationship between the proportion of people using a product and the demand for that product. In other words the more people who are using a product the greater the probability of any individual starting to use the product. This effect accounts for fads and fashion trends. It also can play a crucial role in the development or acquisition of market power. The most famous current example is the market dominance of the Microsoft operating system in personal computers.

* **Legal barriers:** Legal rights can provide opportunity to monopolise the market of a good. Intellectual property rights, including patents and copyrights, give a monopolist exclusive control of the production and selling of certain goods. Property rights may give a company exclusive control of the materials necessary to produce a good.
* **Deliberate actions:** A company wanting to monopolise a market may engage in various types of deliberate action to exclude competitors or eliminate competition. Such actions include collusion, lobbying governmental authorities, and force (see [anti-competitive practices](http://en.wikipedia.org/wiki/Anti-competitive_practices)).

In addition to barriers to entry and competition, barriers to exit may be a source of market power. Barriers to exit are market conditions that make it difficult or expensive for a company to end its involvement with a market. Great liquidation costs are a primary barrier for exiting. Market exit and shutdown are separate events. The decision whether to shut down or operate is not affected by exit barriers. A company will shut down if price falls below minimum average variable costs.

## Oligopoly

An **oligopoly** is a [market form](http://en.wikipedia.org/wiki/Market_form) in which a [market](http://en.wikipedia.org/wiki/Market) or [industry](http://en.wikipedia.org/wiki/Industry) is dominated by a small number of sellers (oligopolists). Because there are few sellers, each oligopolist is likely to be aware of the actions of the others. The decisions of one firm influence, and are influenced by, the decisions of other firms. [Strategic planning](http://en.wikipedia.org/wiki/Strategic_planning) by oligopolists needs to take into account the likely responses of the other market participants.

Oligopoly is a common market form. As a quantitative description of oligopoly, the four-firm [concentration ratio](http://en.wikipedia.org/wiki/Concentration_ratio) is often utilized. This measure expresses the market share of the four largest firms in an industry as a percentage. For example, as of fourth quarter 2008, Verizon, AT&T, Sprint, Nextel, and T-Mobile together control 89% of the US cellular phone market.

Oligopolistic [competition](http://en.wikipedia.org/wiki/Competition) can give rise to a wide range of different outcomes. In some situations, the firms may employ restrictive trade practices ([collusion](http://en.wikipedia.org/wiki/Collusion), market sharing etc.) to raise prices and restrict production in much the same way as a [monopoly](http://en.wikipedia.org/wiki/Monopoly). Where there is a formal agreement for such collusion, this is known as a [cartel](http://en.wikipedia.org/wiki/Cartel). A primary example of such a cartel is [OPEC](http://en.wikipedia.org/wiki/OPEC) which has a profound influence on the international price of oil.

Firms often collude in an attempt to stabilize unstable markets, so as to reduce the risks inherent in these markets for investment and product development. There are legal restrictions on such collusion in most countries. There does not have to be a formal agreement for collusion to take place (although for the act to be illegal there must be actual communication between companies)–for example, in some industries there may be an acknowledged market leader which informally sets prices to which other producers respond, known as [price leadership](http://en.wikipedia.org/wiki/Price_leadership).

In other situations, competition between sellers in an oligopoly can be fierce, with relatively low prices and high production. This could lead to an efficient outcome approaching [perfect competition](http://en.wikipedia.org/wiki/Perfect_competition). The competition in an oligopoly can be greater when there are more firms in an industry than if; for example, the firms were only regionally based and did not compete directly with each other.

## Characteristics

**Profit maximization conditions**: An oligopoly maximizes profits by producing where marginal revenue equals marginal costs.

**Ability to set price**: Oligopolies are price setters rather than price takers.

**Entry and exit**: Barriers to entry are high. The most important barriers are economies of scale, patents, access to expensive and complex technology, and strategic actions by incumbent firms designed to discourage or destroy nascent firms. Additional sources of barriers to entry often result from government regulation favouring existing firms making it difficult for new firms to enter the market.

**Number of firms**: "Few" – a "handful" of sellers.There are so few firms that the actions of one firm can influence the actions of the other firms.

**Long run profits**: Oligopolies can retain long run abnormal profits. High barriers of entry prevent sideline firms from entering market to capture excess profits.

**Product differentiation**: Product may be homogeneous (steel) or differentiated (automobiles).

**Perfect knowledge**: Assumptions about perfect knowledge vary but the knowledge of various economic actors can be generally described as selective. Oligopolies have perfect knowledge of their own cost and demand functions but their inter-firm information may be incomplete. Buyers have only imperfect knowledge as to price,cost and product quality.

**Interdependence**: The distinctive feature of an oligopoly is interdependence.Oligopolies are typically composed of a few large firms. Each firm is so large that its actions affect market conditions. Therefore the competing firms will be aware of a firm's market actions and will respond appropriately. This means that in contemplating a market action, a firm must take into consideration the possible reactions of all competing firms and the firm's countermoves.It is very much like a game of chess or pool in which a player must anticipate a whole sequence of moves and countermoves in determining how to achieve his objectives. For example, an oligopoly considering a price reduction may wish to estimate the likelihood that competing firms would also lower their prices and possibly trigger a ruinous price war. Or if the firm is considering a price increase, it may want to know whether other firms will also increase prices or hold existing prices constant. This high degree of interdependence and need to be aware of what the other guy is doing or might do is to be contrasted with lack of interdependence in other market structures. In a PC market there is zero interdependence because no firm is large enough to affect market price. All firms in a PC market are price takers, information which they robotically follow in maximizing profits. In a monopoly there are no competitors to be concerned about. In a monopolistically competitive market each firm's effects on market conditions is so negligible as to be safely ignored by competitors.

## Duopoly

A true **duopoly** is a specific type of [oligopoly](http://en.wikipedia.org/wiki/Oligopoly) where only two producers exist in one [market](http://en.wikipedia.org/wiki/Market). In reality, this definition is generally used where only two firms have dominant control over a [market](http://en.wikipedia.org/wiki/Market). In the field of [industrial organization](http://en.wikipedia.org/wiki/Industrial_organization), it is the most commonly studied form of oligopoly due to its simplicity.

## Perfect competition

In [economic theory](http://en.wikipedia.org/wiki/Economic_theory), **perfect competition** describes markets such that no participants are large enough to have the [market power](http://en.wikipedia.org/wiki/Market_power) to set the price of a homogeneous product. Because the conditions for perfect competition are strict, there are few if any perfectly competitive markets. Still, buyers and sellers in some [auction](http://en.wikipedia.org/wiki/Auction)-type markets say for [commodities](http://en.wikipedia.org/wiki/Commodities) or some financial assets may approximate the concept. Perfect competition serves as a benchmark against which to measure real-life and [imperfectly competitive](http://en.wikipedia.org/wiki/Imperfect_competition) markets.

## Basic structural characteristics

Generally, a perfectly competitive market exists when every participant is a "[price taker](http://en.wikipedia.org/wiki/Price_taker)", and no participant influences the price of the product it buys or sells. Specific characteristics may include:

* **Infinite buyers and sellers** – Infinite consumers with the willingness and ability to buy the product at a certain price, and infinite producers with the willingness and ability to supply the product at a certain price.
* **Zero entry and exit barriers** – It is relatively easy for a business to enter or exit in a perfectly competitive market.
* **Perfect factor mobility** - In the long run [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) are perfectly mobile allowing free long term adjustments to changing market conditions.
* **Perfect information** - Prices and quality of products are assumed to be known to all consumers and producers.
* **Zero transaction costs** - Buyers and sellers incur no costs in making an exchange (perfect mobility).
* **Profit maximization** - Firms aim to sell where marginal costs meet marginal revenue, where they generate the most profit.
* **Homogeneous products** – The characteristics of any given market good or service do not vary across suppliers.
* **Non-increasing returns to scale** - Non-increasing [returns to scale](http://en.wikipedia.org/wiki/Returns_to_scale) ensure that there are sufficient firms in the industry.

## Imperfect competition

In [economic theory](http://en.wikipedia.org/wiki/Economic_theory), **imperfect competition** is the competitive situation in any market where the conditions necessary for [perfect competition](http://en.wikipedia.org/wiki/Perfect_competition) are not satisfied. It is a [market structure](http://en.wikipedia.org/wiki/Market_structure) that does not meet the conditions of perfect competition.

Forms of imperfect competition include:

* [Monopoly](http://en.wikipedia.org/wiki/Monopoly), in which there is only one seller of a good.
* [Oligopoly](http://en.wikipedia.org/wiki/Oligopoly), in which there are few sellers of a good.
* [Monopolistic competition](http://en.wikipedia.org/wiki/Monopolistic_competition), in which many sellers are producing highly differentiated goods.
* [Monopsony](http://en.wikipedia.org/wiki/Monopsony), in which there is only one buyer of a good.
* [Oligopsony](http://en.wikipedia.org/wiki/Oligopsony), in which there are few buyers of a good.
* [Information asymmetry](http://en.wikipedia.org/wiki/Information_asymmetry) when one competitor has the advantage of more or better information.

There may also be imperfect competition due to a time lag in a market. An example is the “[jobless recovery](http://en.wikipedia.org/wiki/Jobless_recovery)”. There are many growth opportunities available after a recession, but it takes time for employers to react, leading to high [unemployment](http://en.wikipedia.org/wiki/Unemployment). High unemployment decreases wages, which makes hiring more attractive, but it takes time for new jobs to be created.

## Monopolistic competition

**Monopolistic competition** is a type of [imperfect competition](http://en.wikipedia.org/wiki/Imperfect_competition) such that one or two producers sell products that are [differentiated](http://en.wikipedia.org/wiki/Differentiation_(economics)) from one another as goods but not perfect [substitutes](http://en.wikipedia.org/wiki/Substitute_good) (such as from branding, quality, or location). In monopolistic competition, a firm takes the prices charged by its rivals as given and ignores the impact of its own prices on the prices of other firms.

In a monopolistically competitive market, firms can behave like [monopolies](http://en.wikipedia.org/wiki/Monopolies) in the [short run](http://en.wikipedia.org/wiki/Short_run), including by using market power to generate profit. In the [long run](http://en.wikipedia.org/wiki/Long_run), however, other firms enter the market and the benefits of differentiation decrease with competition; the market becomes more like a [perfectly competitive](http://en.wikipedia.org/wiki/Perfect_competition) one where firms cannot gain economic profit. In practice, however, if consumer rationality/innovativeness is low and heuristics are preferred, **monopolistic competition** can fall into [natural monopoly](http://en.wikipedia.org/wiki/Natural_monopoly), even in the complete absence of government intervention. In the presence of coercive government, monopolistic competition will fall into [government-granted monopoly](http://en.wikipedia.org/wiki/Government-granted_monopoly). Unlike perfect competition, the firm maintains spare capacity. Models of monopolistic competition are often used to model industries. Textbook examples of industries with market structures similar to monopolistic competition include [restaurants](http://en.wikipedia.org/wiki/Restaurants), [cereal](http://en.wikipedia.org/wiki/Cereal), [clothing](http://en.wikipedia.org/wiki/Clothing), [shoes](http://en.wikipedia.org/wiki/Shoes), and service industries in large cities.

Monopolistically competitive markets have the following characteristics:

* There are many producers and many consumers in the market, and no business has total control over the market price.
* Consumers perceive that there are non-price differences among the competitors' products.
* There are few [barriers to entry](http://en.wikipedia.org/wiki/Barriers_to_entry) and exit.
* Producers have a degree of control over price.

## Major characteristics

There are six characteristics of monopolistic competition (MC):

* Product differentiation
* Many firms
* Free entry and exit in the long run
* Independent decision making
* Market Power
* Buyers and Sellers do not have perfect information (Imperfect Information)

## Perfect market

In [economics](http://en.wikipedia.org/wiki/Economics), a **perfect market** is defined by several conditions, collectively called [perfect competition](http://en.wikipedia.org/wiki/Perfect_competition). Among these conditions are

* Perfect market information
* No participant with market power to set prices
* No barriers to entry or exit
* Equal access to production technology

The mathematical theory is called [general equilibrium theory](http://en.wikipedia.org/wiki/General_equilibrium_theory). On the assumption of Perfect Competition, and some technical assumptions about the shapes of supply and demand curves, it is possible to prove that a market will reach equilibrium in which supply for every product or service, including labour, equals demand at the current price. This equilibrium will be a [Pareto optimum](http://en.wikipedia.org/wiki/Pareto_optimum), meaning that nobody can be made better off by exchange without making someone else worse off.

Another characteristics of a Perfect Market is [normal profits](http://en.wikipedia.org/wiki/Normal_profits), just enough to induce enough participants to stay in the market to satisfy customer demand. The least efficient producer may have very small profits, and be unable, for example, to pay dividends to shareholders, while more efficient producers have larger profits.

## General equilibrium theory

**General equilibrium theory** is a branch of theoretical [economics](http://en.wikipedia.org/wiki/Economics). It seeks to explain the behaviour of supply, demand, and prices in a whole economy with several or many interacting markets, by seeking to prove that a set of prices exists that will result in an overall equilibrium, hence *general* equilibrium, in contrast to [*partial* equilibrium](http://en.wikipedia.org/wiki/Partial_equilibrium), which only analyzes single markets. As with all models, this is an abstraction from a real economy; it is proposed as being a useful model, both by considering equilibrium prices as long-term prices and by considering actual prices as deviations from equilibrium.

General equilibrium theory both studies economies using the model of equilibrium pricing and seeks to determine in which circumstances the assumptions of general equilibrium will hold.

## Marginal product of labour

In economics, the **marginal product of labour** also known as **MPL** is the change in output that results from employing an added unit of labour

## Definition

The marginal product of a [factor of production](http://en.wikipedia.org/wiki/Factor_of_production) is generally defined as the change in output associated with a change in that factor, holding other inputs into production constant.

The marginal product of labour is then the change in output (Y) per unit change in labour (L). In discrete terms the marginal product of labour is

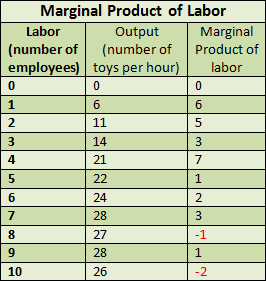
\frac {\Delta Y} {\Delta L}.

In continuous terms the MPL is the first derivative of the [production function](http://en.wikipedia.org/wiki/Production_function):

\frac {\partial Y} {\partial L}.

Graphically the MPL is the slope of the production function.

## Examples

[](http://en.wikipedia.org/wiki/File:Marginal_Product_of_Labor1_copy.png)

Marginal product of labour table.

There is a factory which produces toys. When there are no workers in the factory, no toys are produced. When there is one worker in the factory, six toys are produced per hour. When there are two workers in the factory, eleven toys are produced per hour. There is a marginal product of labour of 5 when there are two workers in the factory compared to one. When the marginal product of labour is positive, this is called [increasing marginal returns](http://en.wikipedia.org/wiki/Increasing_marginal_returns). However, as the number of workers increases, the marginal product of labour may not increase indefinitely. When not [scaled](http://en.wikipedia.org/wiki/Scale_(social_sciences)) properly, the marginal product of labour may go down when the number of employees goes up, creating a situation known as [diminishing marginal returns](http://en.wikipedia.org/wiki/Diminishing_marginal_returns). When the marginal product of labour becomes negative, it is known as [negative marginal returns](http://en.wikipedia.org/w/index.php?title=Negative_marginal_returns&action=edit&redlink=1).

# V International Sector

## Comparative advantage

In [economics](http://en.wikipedia.org/wiki/Economics), the theory of **comparative advantage** refers to the ability of a person or a country to produce a particular good or service at a lower [marginal](http://en.wikipedia.org/wiki/Marginal_cost) and [opportunity cost](http://en.wikipedia.org/wiki/Opportunity_cost) over another. Even if one country is more efficient in the production of all goods ([absolute advantage](http://en.wikipedia.org/wiki/Absolute_advantage) in all goods) than the other, both countries will still gain by trading with each other, as long as they have different relative efficiencies.

For example, if, using machinery, a worker in one country can produce both shoes and shirts at 6 per hour, and a worker in a country with less machinery can produce either 2 shoes or 4 shirts in an hour, each country can gain from trade because their internal trade-offs between shoes and shirts are different. The less-efficient country has a comparative advantage in shirts, so it finds it more efficient to produce shirts and trade them to the more-efficient country for shoes. Without trade, its [opportunity cost](http://en.wikipedia.org/wiki/Opportunity_cost) per shoe was 2 shirts; by trading, its cost per shoe can reduce to as low as 1 shirt depending on how much trade occurs (since the more-efficient country has a 1:1 trade-off). The more-efficient country has a comparative advantage in shoes, so it can gain in efficiency by moving some workers from shirt-production to shoe-production and trading some shoes for shirts. Without trade, its cost to make a shirt was 1 shoe; by trading, its cost per shirt can go as low as 1/2 shoe depending on how much trade occurs.

The net benefits to each country are called the [gains from trade](http://en.wikipedia.org/wiki/Gains_from_trade).

## Effect of trade costs

Trade costs, particularly transportation, reduce and may eliminate the benefits from trade, including comparative advantage. [Paul Krugman](http://en.wikipedia.org/wiki/Paul_Krugman) gives the following example.

Using Ricardo's classic example:

|  |  |  |
| --- | --- | --- |
| **Unit labour costs** | | |
|  | **Cloth** | **Wine** |
| **Britain** | 100 | 110 |
| **Portugal** | 90 | 80 |

In the absence of transportation costs, it is efficient for Britain to produce cloth, and Portugal to produce wine, as, assuming that these trade at equal price (1 unit of cloth for 1 unit of wine) Britain can then obtain wine at a cost of 100 labour units by producing cloth and trading, rather than 110 units by producing the wine itself, and Portugal can obtain cloth at a cost of 80 units by trade rather than 90 by production.

However, in the presence of trade costs of 15 units of labour to import a good (alternatively a mix of export labour costs and import labour costs, such as 5 units to export and 10 units to import), it then costs Britain 115 units of labour to obtain wine by trade – 100 units for producing the cloth, 15 units for importing the wine, which is more expensive than producing the wine locally, and likewise for Portugal. Thus, if trade costs exceed the production advantage, it is not advantageous to trade.

Krugman proceeds to argue more speculatively that changes in the cost of trade (particularly transportation) *relative* to the cost of production may be a factor in changes in global patterns of trade: if trade costs decrease, such as on the advent of steam-powered shipping, trade should be expected to increase, as more comparative advantages in production can be realized. Conversely, if trade costs increase, or if production costs decrease faster than trade costs (such as via electrification of factories), then trade should be expected to decrease, as trade costs become a more significant barrier.

## Competitive advantage

An advantage that a firm has over its competitors, allowing it to generate greater sales or margins and/or retains more customers than its competition. There can be many types of competitive advantages including the firm's cost structure, product offerings, distribution network and customer support. Competitive advantages give a company an edge over its rivals and an ability to generate greater value for the firm and its shareholders. The more sustainable the competitive advantage, the more difficult it is for competitors to neutralize the advantage.  
There are two main types of competitive advantages: comparative advantage and differential advantage. Comparative advantage, or cost advantage, is a firm's ability to produce a good or service at a lower cost than its competitors, which gives the firm the ability sell its goods or services at a lower price than its competition or to generate a larger margin on sales. A differential advantage is created when a firm's products or services differ from its competitors and are seen as better than a competitor's products by customers.  
Read more: <http://www.investopedia.com/terms/c/competitive_advantage.asp#ixzz1wvHzsCLD>  
Inflation

In economics, **inflation** is a rise in the general [level of prices](http://en.wikipedia.org/wiki/Price_level) of goods and services in an economy over a period of time.When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation also reflects erosion in the [purchasing power](http://en.wikipedia.org/wiki/Purchasing_power) of money – a loss of real value in the internal medium of exchange and unit of account in the economy. A chief measure of price inflation is the [inflation rate](http://en.wikipedia.org/wiki/Inflation_rate), the annualized percentage change in a general [price index](http://en.wikipedia.org/wiki/Price_index) (normally the [Consumer Price Index](http://en.wikipedia.org/wiki/Consumer_Price_Index)) over time.

Inflation's effects on an economy are various and can be simultaneously [positive](http://en.wikipedia.org/wiki/Inflation#Positive) and [negative](http://en.wikipedia.org/wiki/Inflation#Negative). Negative effects of inflation include a decrease in the real value of money and other monetary items over time, uncertainty over future inflation which may discourage investment and savings, and if inflation is rapid enough, shortages of [goods](http://en.wikipedia.org/wiki/Good_(economics)) as consumers begin [hoarding](http://en.wikipedia.org/wiki/Hoarding) out of concern that prices will increase in the future. Positive effects include ensuring central banks can adjust [nominal interest rates](http://en.wikipedia.org/wiki/Nominal_interest_rate) (intended to mitigate [recessions](http://en.wikipedia.org/wiki/Recession)),and encouraging investment in non-monetary capital projects.

Economists generally agree that high rates of inflation and [hyperinflation](http://en.wikipedia.org/wiki/Hyperinflation) are caused by an excessive growth of the [money supply](http://en.wikipedia.org/wiki/Money_supply).Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in [real](http://en.wikipedia.org/wiki/Real_versus_nominal_value_(economics)) [demand](http://en.wikipedia.org/wiki/Demand) for goods and services, or changes in available supplies such as during [scarcities](http://en.wikipedia.org/wiki/Scarcity), as well as to growth in the money supply. However, the consensus view is that a long sustained period of inflation is caused by money supply growing faster than the rate of economic growth.

Today, most ecofavourts favour a low, steady rate of inflation.Low (as opposed to zero or [negative](http://en.wikipedia.org/wiki/Deflation)) inflation reduces the severity of economic [recessions](http://en.wikipedia.org/wiki/Recessions) by enabling the labour market to adjust more quickly in a downturn, and reduces the risk that a [liquidity trap](http://en.wikipedia.org/wiki/Liquidity_trap) prevents [monetary policy](http://en.wikipedia.org/wiki/Monetary_policy) from stabilizing the economy. The task of keeping the rate of inflation low and stable is usually given to [monetary authorities](http://en.wikipedia.org/wiki/Monetary_authority). Generally, these monetary authorities are the [central banks](http://en.wikipedia.org/wiki/Central_bank) that control [monetary policy](http://en.wikipedia.org/wiki/Monetary_policy) through the setting of [interest rates](http://en.wikipedia.org/wiki/Interest_rate), through [open market operations](http://en.wikipedia.org/wiki/Open_market_operations), and through the setting of banking [reserve requirements](http://en.wikipedia.org/wiki/Reserve_requirements).

## Free trade

**Free trade** is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. According to the law of [comparative advantage](http://en.wikipedia.org/wiki/Comparative_advantage) the policy permits trading partners mutual [gains from trade](http://en.wikipedia.org/wiki/Gains_from_trade) of goods and services.

Under a free trade policy, prices emerge from [supply and demand](http://en.wikipedia.org/wiki/Supply_and_demand), and are the sole determinant of [resource allocation](http://en.wikipedia.org/wiki/Resource_allocation). 'Free' trade differs from other forms of trade policy where the allocation of goods and services among trading countries are determined by price strategies that may differ from those that would emerge under deregulation. These governed prices are the result of government intervention in the market through price adjustments or supply restrictions, including [protectionist](http://en.wikipedia.org/wiki/Protectionist) policies. Such government interventions can increase as well as decrease the cost of goods and services to both consumers and producers. Since the mid-20th century, nations have increasingly reduced tariff barriers and currency restrictions on [international trade](http://en.wikipedia.org/wiki/International_trade). Other barriers, however, that may be equally effective in hindering trade include [import quotas](http://en.wikipedia.org/wiki/Import_quotas), taxes, and diverse means of subsidizing domestic industries. Interventions include [subsidies](http://en.wikipedia.org/wiki/Subsidies), [taxes](http://en.wikipedia.org/wiki/Taxes) and [tariffs](http://en.wikipedia.org/wiki/Tariff), [non-tariff barriers](http://en.wikipedia.org/wiki/Non-tariff_barrier), such as regulatory [legislation](http://en.wikipedia.org/wiki/Legislation) and import quotas, and even inter-government managed trade agreements such as the [North American Free Trade Agreement](http://en.wikipedia.org/wiki/North_American_Free_Trade_Agreement) (NAFTA) and [Central America Free Trade Agreement](http://en.wikipedia.org/wiki/Central_America_Free_Trade_Agreement) (CAFTA) (contrary to their formal titles) and any governmental market intervention resulting in artificial prices.

## Features of free trade

Free trade implies the following features:

* Trade of [goods](http://en.wikipedia.org/wiki/Good_(accounting)) without taxes (including tariffs) or other [trade barriers](http://en.wikipedia.org/wiki/Trade_barrier) (e.g., quotas on imports or subsidies for producers)
* Trade in services without taxes or other trade barriers
* The absence of "trade-distorting" policies (such as taxes, subsidies, [regulations](http://en.wikipedia.org/wiki/Regulation), or laws) that give some [firms](http://en.wikipedia.org/wiki/Business_entity), households, or [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) an advantage over others
* Free access to [markets](http://en.wikipedia.org/wiki/Market)
* Free access to market information
* Inability of firms to distort markets through government-imposed [monopoly](http://en.wikipedia.org/wiki/Monopoly) or [oligopoly](http://en.wikipedia.org/wiki/Oligopoly) power

## Terms of trade

In international [economics](http://en.wikipedia.org/wiki/Economics) and [international trade](http://en.wikipedia.org/wiki/International_trade), **terms of trade** or TOT is (Price of exportable goods), (Price of importable goods). In layman's terms it means what quantity of imports can be purchased through the sale of a fixed quantity of exports. "Terms of trade" are sometimes used as a proxy for the relative [social welfare](http://en.wikipedia.org/wiki/Social_welfare) of a country, but this heuristic is technically questionable and should be used with extreme caution. An improvement in a nation's terms of trade (the increase of the ratio) is good for that country in the sense that it can buy more imports for any given level of exports. The terms of trade is influenced by the exchange rate because a rise in the value of a country's currency lowers the domestic prices for its imports but does not directly affect the commodities it produces (i.e. its exports).

**Protectionism**

**Protectionism** is the [economic policy](http://en.wikipedia.org/wiki/Economic_policy) of restraining [trade](http://en.wikipedia.org/wiki/Trade) between states through methods such as [tariffs](http://en.wikipedia.org/wiki/Tariff) on imported goods, restrictive [quotas](http://en.wikipedia.org/wiki/Import_quota), and a variety of other government regulations designed to allow (according to proponents) "fair competition" between [imports](http://en.wikipedia.org/wiki/Import) and goods and services produced domestically.

This policy contrasts with [free trade](http://en.wikipedia.org/wiki/Free_trade), where government barriers to trade are kept to a minimum. In recent years, it has become closely aligned with [anti-globalization](http://en.wikipedia.org/wiki/Anti-globalization). The term is mostly used in the context of [economics](http://en.wikipedia.org/wiki/Economics), where **protectionism** refers to policies or doctrines which protect businesses and workers within a country by restricting or regulating trade with foreign nations.

## International trade

**International trade** is the exchange of [capital](http://en.wikipedia.org/wiki/Capital_(economics)), [goods](http://en.wikipedia.org/wiki/Good_(economics)), and [services](http://en.wikipedia.org/wiki/Service_(economics)) across [international borders](http://en.wikipedia.org/wiki/International_borders) or territories.  In most countries, such trade represents a significant share of [gross domestic product](http://en.wikipedia.org/wiki/Gross_domestic_product)(GDP). While international [trade](http://en.wikipedia.org/wiki/Trade) has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries.

[Industrialization](http://en.wikipedia.org/wiki/Industrialization), advanced [transportation](http://en.wikipedia.org/wiki/Transport), [globalization](http://en.wikipedia.org/wiki/Globalization), [multinational corporations](http://en.wikipedia.org/wiki/Multinational_corporation), and [outsourcing](http://en.wikipedia.org/wiki/Outsourcing) are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of [globalization](http://en.wikipedia.org/wiki/Globalization). Without international trade, nations would be limited to the goods and services produced within their own borders.

International trade is, in principle, not different from [domestic trade](http://en.wikipedia.org/wiki/Domestic_trade) as the motivation and the behaviour of parties involved in a trade do not change fundamentally regardless of whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as [tariffs](http://en.wikipedia.org/wiki/Tariff), time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

Another difference between domestic and international trade is that [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) such as capital and labour are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labour or other factors of production. Trade in goods and services can serve as a substitute for trade in factors of production.

Instead of importing a factor of production, a country can import goods that make intensive use of that factor of production and thus embody it. An example is the import of labour-intensive goods by the United States from China. Instead of importing Chinese labour, the United States imports goods that were produced with Chinese labour. One report in 2010 suggested that international trade was increased when a country hosted a network of immigrants, but the trade effect was weakened when the immigrants became assimilated into their new country.

International trade is also a branch of [economics](http://en.wikipedia.org/wiki/Economics), which, together with [international finance](http://en.wikipedia.org/wiki/International_finance), forms the larger branch of [international economics](http://en.wikipedia.org/wiki/International_economics).

## Trade barriers

**Trade barriers** are government-induced restrictions on [international trade](http://en.wikipedia.org/wiki/International_trade). The barriers can take many forms, including the following:

* [Tariffs](http://en.wikipedia.org/wiki/Tariff)
* [Non-tariff barriers to trade](http://en.wikipedia.org/wiki/Non-tariff_barriers_to_trade)
  + [Import licenses](http://en.wikipedia.org/wiki/Import_license)
  + Export licenses
  + [Import quotas](http://en.wikipedia.org/wiki/Import_quota)
  + [Subsidies](http://en.wikipedia.org/wiki/Subsidies)
  + [Voluntary Export Restraints](http://en.wikipedia.org/wiki/Voluntary_Export_Restraints)
  + Local content requirements
  + [Embargo](http://en.wikipedia.org/wiki/Embargo)
  + [Currency devaluation](http://en.wikipedia.org/wiki/Devaluation)
  + [Trade restriction](http://en.wikipedia.org/wiki/Trade_restriction)

Most trade barriers work on the same principle: the imposition of some sort of [cost](http://en.wikipedia.org/wiki/Cost) on trade that raises the price of the traded [products](http://en.wikipedia.org/wiki/Product_(business)). If two or more nations repeatedly use trade barriers against each other, then a [trade war](http://en.wikipedia.org/wiki/Trade_war) results.

Economists generally agree that trade barriers are detrimental and decrease overall [economic efficiency](http://en.wikipedia.org/wiki/Efficiency_(economics)), this can be explained by the [theory of comparative advantage](http://en.wikipedia.org/wiki/Comparative_advantage). In theory, [free trade](http://en.wikipedia.org/wiki/Free_trade) involves the removal of all such barriers, except perhaps those considered necessary for health or national security. In practice, however, even those countries promoting free trade heavily subsidize certain industries, such as [agriculture](http://en.wikipedia.org/wiki/Agriculture) and [steel](http://en.wikipedia.org/wiki/Steel).

Trade barriers are often criticized for the effect they have on the developing world. Because rich-country players call most of the shots and set trade policies, goods such as crops that developing countries are best at producing still face high barriers. Trade barriers such as taxes on food imports or subsidies for farmers in developed economies lead to overproduction and dumping on world markets, thus lowering prices and hurting poor-country farmers. Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labour-intensive processed goods. The [Commitment to Development Index](http://en.wikipedia.org/wiki/Commitment_to_Development_Index) measures the effect that rich country trade policies actually have on the developing world.

Another negative aspect of trade barriers is that it would cause a limited choice of products and would therefore force customers to pay higher prices and accept inferior quality

## Examples of free trade areas

* [North American Free Trade Agreement](http://en.wikipedia.org/wiki/North_American_Free_Trade_Agreement) (NAFTA)
* [South Asia Free Trade Agreement](http://en.wikipedia.org/wiki/South_Asia_Free_Trade_Agreement) (SAFTA)
* [European Free Trade Association](http://en.wikipedia.org/wiki/European_Free_Trade_Association)
* [European Union](http://en.wikipedia.org/wiki/European_Union) (EU)
* [Union of South American Nations](http://en.wikipedia.org/wiki/Union_of_South_American_Nations)
* [New West Partnership](http://en.wikipedia.org/wiki/New_West_Partnership) (An internal free-trade zone in Canada between Alberta, British Columbia, and Saskatchewan)
* [Gulf Cooperation Council common market](http://en.wikipedia.org/wiki/Cooperation_Council_for_the_Arab_States_of_the_Gulf)

Other trade barriers include differences in culture, customs, traditions, laws, language and currency.

Trading barriers include farming produce industry.

## Public limited company

A **public limited company** (legally abbreviated to *PLC* or *plc*) is a kind of [public company](http://en.wikipedia.org/wiki/Public_company) (publicly held company) in the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom_company_law), the [Republic of Ireland](http://en.wikipedia.org/wiki/Republic_of_Ireland), and other [Commonwealth](http://en.wikipedia.org/wiki/Commonwealth) jurisdictions. It is a [limited (liability) company](http://en.wikipedia.org/wiki/Limited_liability) whose shares are freely sold and traded to the public, with a minimum [share capital](http://en.wikipedia.org/wiki/Share_capital) of £50,000 and the letters PLC after its name. Similar companies in the United States are called *publicly traded companies*.

A PLC can be either an unlisted or listed company on the [stock exchanges](http://en.wikipedia.org/wiki/Stock_exchange). In the United Kingdom, a public limited company usually must include the words "public limited company" or the abbreviation "PLC" or "plc" at the end and as part of the legal company name. Welsh companies may instead choose to end their names with c.c.c. However, some public limited companies (mostly [nationalised](http://en.wikipedia.org/wiki/Nationalization) concerns) incorporated under special legislation are exempted from bearing any of the identifying suffixes.

## Private company limited by shares

A **private company limited by shares**, usually called a **private limited company (Ltd.)** (though this can theoretically also refer to a [private company limited by guarantee](http://en.wikipedia.org/wiki/Private_company_limited_by_guarantee)), is a type of [company](http://en.wikipedia.org/wiki/Company_(law)) incorporated under the [laws of England and Wales](http://en.wikipedia.org/wiki/English_law), [Scotland](http://en.wikipedia.org/wiki/Scots_law), that of certain [Commonwealth countries](http://en.wikipedia.org/wiki/Commonwealth_of_Nations) and the [Republic of Ireland](http://en.wikipedia.org/wiki/Republic_of_Ireland). It has [shareholders](http://en.wikipedia.org/wiki/Shareholders) with [limited liability](http://en.wikipedia.org/wiki/Limited_liability) and its [shares](http://en.wikipedia.org/wiki/Shares) may not be offered to the general public, unlike those of a [public limited company](http://en.wikipedia.org/wiki/Public_limited_company) (plc).

"Limited by shares" means that the company has shareholders, and that the liability of the shareholders to [creditors](http://en.wikipedia.org/wiki/Creditors) of the company is limited to the [capital](http://en.wikipedia.org/wiki/Capital_(economics)) originally invested, i.e. the [nominal value](http://en.wikipedia.org/wiki/Nominal_value) of the shares and any premium paid in return for the issue of the shares by the company. A shareholder's personal assets are thereby protected in the event of the company's insolvency, but money invested in the company will be lost.

A limited company may be "private" or "public". A private limited company's [disclosure](http://en.wikipedia.org/wiki/Corporation#Financial_disclosure) requirements are lighter, but for this reason its shares may not be offered to the general public (and therefore cannot be traded on a public [stock exchange](http://en.wikipedia.org/wiki/Stock_exchange)). This is the major distinguishing feature between a private limited company and a [public limited company](http://en.wikipedia.org/wiki/Public_limited_company). Most companies, particularly small companies, are private.

Private companies limited by shares are usually required to have the suffix "Limited" (often written "Ltd" or "Ltd.") or "Incorporated" ("Inc.") as part of their name, though the latter cannot be used in the UK or the Republic of Ireland; companies set up by [Act of Parliament](http://en.wikipedia.org/wiki/Acts_of_Parliament_in_the_United_Kingdom) may not have Limited in their name. In the Republic of Ireland "Teoranta" ("Teo.") may be used instead, largely by [Gaeltacht](http://en.wikipedia.org/wiki/Gaeltacht) companies. "Cyfyngedig" ("Cyf.") may be used by Welsh companies in a similar fashion.

## Requirements

### *Share capital*

When a Limited Company is formed it must issue one or more [subscriber shares](http://en.wikipedia.org/w/index.php?title=Subscriber_shares&action=edit&redlink=1) to its initial members. It may increase capitalisation by issue of further shares. The issued share capital of the company is the total number of shares existing in the company multiplied by the nominal value of each share.

A company incorporated in England and Wales can be created with any number of shares of any value, in any currency. For example, there may be 10,000 shares with a nominal value of 1p, or 100 shares each of £1. In each case the share capital would be £100.

Unissued shares can be issued at any time by the directors using a Form SH01 - Return of Allotment of Shares (Pursuant to Companies Act, 2006) subject to prior authorization by the shareholders.

Shares in a private company are usually transferred by private agreement between the seller and the buyer, as shares in a private company may not by law be offered to the general public. A stock transfer form is required to register the transfer with the company. The articles of association of private companies often place restrictions on the transfer of shares.

### Company accounts

A company's first accounts must start on the day of incorporation. The first financial year must end on the [accounting reference date](http://en.wikipedia.org/wiki/Accounting_reference_date), or a date up to seven days either side of this date. Subsequent accounts start on the day following the year-end date of the previous accounts. They end on the next accounting reference date or a date up to seven days either side.

To help companies meet this filing requirement, Companies House send a pre-printed "shuttle" form to its registered office several weeks before the anniversary of incorporation. This will show the information that has already given to Companies House. If a company's accounts are delivered late there is an automatic penalty. This is between £100 and £1,000 for a private company.

The first accounts of a private company must be delivered:

* within 10 months of the end of the accounting reference period until April 2008, when it was reduced to 9 months; or
* if the accounting reference period is more than 12 months, within 22 months of the date of incorporation, or three months from the end of the accounting reference period, whichever is longer.

A company may change its accounting reference date by sending Form 225 to the Registrar.

### Registered office

Every company must have a registered office, which does not need to be its usual business address. It is sometimes the company's lawyers or accountants, for example. All official letters and documentation from the government departments (including Inland Revenue and Companies House) will be sent to this address, and it must be shown on all official company documentation. The registered office can be anywhere in England and Wales (or Scotland if the company is registered there). If a company changes its registered office address after incorporation, the new address must be notified to Companies House on Form AD01.

## Formation

To incorporate a company in the UK (other than Northern Ireland) the following documents, together with the registration fee (currently £40), must be sent to the Registrar of Companies:

* Form IN01
* The [articles of association](http://en.wikipedia.org/wiki/Articles_of_association)
* The [memorandum of association](http://en.wikipedia.org/wiki/Memorandum_of_association)

The memorandum of association states the name of the company, the registered office and the company objectives. The objective of a company may simply be stated as being to carry out business as a general commercial company. The memorandum delivered to the Registrar must be signed by each subscriber in front of a witness who must attest the signature.

The articles of association govern the company's internal affairs. The company's articles delivered to the Registrar must be signed by each subscriber in front of a witness who must attest the signature.

Form IN01 states the first directors, the first secretary and the address of the registered office. Each director must give his or her name, address, date of birth, and occupation. Each officer appointed and each subscriber (or their agent) must sign and date the form.

In other jurisdictions companies must make similar applications to the relevant registrar — the [Northern Ireland Registrar of Companies](http://en.wikipedia.org/w/index.php?title=Northern_Ireland_Registrar_of_Companies&action=edit&redlink=1) in Northern Ireland, the [Companies Registration Office, Ireland](http://en.wikipedia.org/wiki/Companies_Registration_Office,_Ireland) in the [Republic of Ireland](http://en.wikipedia.org/wiki/Republic_of_Ireland), or the [Registrar of Companies](http://en.wikipedia.org/wiki/Registrar_of_Companies) in India.

In reality it is far easier to contact one of the Company Registration services that can now form a company online without your written signature. Companies house now offers this service on their website using a system called business link (currently £18), meaning this method is often cheaper.

## Additional information

### Redundant companies

Private companies that have not traded or otherwise carried on business for at least three months may apply to the Registrar to be struck off the register. Alternatively, the company may be voluntarily liquidated.

### Converting to a public limited company

A private company limited by shares and an unlimited company with a share capital may re-register as a [public limited company](http://en.wikipedia.org/wiki/Public_limited_company) (PLC). A private company must pass a special resolution that it be so re-registered and deliver a copy of the resolution together with an application form 43(3)(e) to the Registrar.

## Privately held company

A **privately held company** or **close corporation** is a business [company](http://en.wikipedia.org/wiki/Company_(law)) owned either by [non-governmental organizations](http://en.wikipedia.org/wiki/Non-governmental_organizations) or by a relatively small number of [shareholders](http://en.wikipedia.org/wiki/Shareholder) or company members which does not offer or trade its company [stock](http://en.wikipedia.org/wiki/Stock)([shares](http://en.wikipedia.org/wiki/Shares)) to the general public on the [stock market](http://en.wikipedia.org/wiki/Stock_market) exchanges, but rather the company's stock is offered, owned and traded or exchanged privately. Less ambiguous terms for a privately held company are **unquoted company** and **unlisted company**.

Though less visible than their [publicly traded](http://en.wikipedia.org/wiki/Public_company) counterparts, private companies have a major importance in the world's [economy](http://en.wikipedia.org/wiki/Economy). In 2008, the 441 largest private companies in the United States accounted for $1.8 trillion in revenues and employed 6.2 million people, according to [Forbes](http://en.wikipedia.org/wiki/Forbes). In 2005, using a substantially smaller pool size (22.7%) for comparison, the 339 companies on [Forbes](http://en.wikipedia.org/wiki/Forbes)' survey of closely held U.S. businesses sold a trillion dollars' worth of goods and services (44%) and employed 4 million people. In 2004, the Forbes' count of privately held U.S. businesses with at least $1 billion in revenue was 305.[[1]](http://en.wikipedia.org/wiki/Privately_held_company#cite_note-0)

[Koch Industries](http://en.wikipedia.org/wiki/Koch_Industries), [Bechtel](http://en.wikipedia.org/wiki/Bechtel), [Cargill](http://en.wikipedia.org/wiki/Cargill), [Publix](http://en.wikipedia.org/wiki/Publix), [Pilot Corp.](http://en.wikipedia.org/wiki/Pilot_Corp.), one of the members of the [Big Four](http://en.wikipedia.org/wiki/Big_Four_(audit_firms)) accounting firms, [Deloitte Touche Tohmatsu](http://en.wikipedia.org/wiki/Deloitte_Touche_Tohmatsu), [Hearst Corporation](http://en.wikipedia.org/wiki/Hearst_Corporation), [S. C. Johnson](http://en.wikipedia.org/wiki/S._C._Johnson), and [Mars](http://en.wikipedia.org/wiki/Mars,_Incorporated) are among the largest privately held companies in the United States. [KPMG](http://en.wikipedia.org/wiki/KPMG), the UK accounting firms, [Ernst & Young](http://en.wikipedia.org/wiki/Ernst_%26_Young) and [PricewaterhouseCoopers](http://en.wikipedia.org/wiki/PricewaterhouseCoopers), [IKEA](http://en.wikipedia.org/wiki/IKEA), [Trafigura](http://en.wikipedia.org/wiki/Trafigura), [J C Bamford Excavators (JCB)](http://en.wikipedia.org/wiki/J._C._Bamford), [LEGO](http://en.wikipedia.org/wiki/Lego_Group), [Bosch](http://en.wikipedia.org/wiki/Robert_Bosch_GmbH), [Rolex](http://en.wikipedia.org/wiki/Rolex) and [Victorinox](http://en.wikipedia.org/wiki/Victorinox) are some examples of Europe's largest privately held companies.

**State ownership vs. private ownership**

In the broadest sense, the term private corporation refers to any business not owned by the state. This usage is often found in former [Communist countries](http://en.wikipedia.org/wiki/Communist_states) to differentiate from former state-owned enterprises, but it may be used anywhere when contrasting to a state-owned company.

In the States, the term *privately held company* is more often used to describe for-profit enterprises whose shares are not traded on the stock market.

**Ownership of stock**

In countries with public trading markets, a privately held business is generally taken to mean one whose ownership [shares](http://en.wikipedia.org/wiki/Shares) or interests are not [publicly traded](http://en.wikipedia.org/wiki/Public_company). Often, privately held companies are owned by the company founders and/or their families and heirs or by a small group of investors. Sometimes employees also hold shares of private companies. Most [small businesses](http://en.wikipedia.org/wiki/Small_business) are privately held.

[Subsidiaries](http://en.wikipedia.org/wiki/Subsidiary) and [joint ventures](http://en.wikipedia.org/wiki/Joint_venture) of publicly traded companies (for example, [General Motors](http://en.wikipedia.org/wiki/General_Motors)' [Saturn Corporation](http://en.wikipedia.org/wiki/Saturn_Corporation)), unless shares in the subsidiary itself are traded directly, have characteristics of both privately held companies and publicly traded companies. Such companies are usually subject to the same reporting requirements as privately held companies, but their assets, liabilities and activities are also included in the reports of their parent companies, as required by the accountancy and securities industry rules relating to groups of companies.

**Form of organization**

Private companies may be called [corporations](http://en.wikipedia.org/wiki/Corporation), [limited companies](http://en.wikipedia.org/wiki/Limited_companies), [limited liability companies](http://en.wikipedia.org/wiki/Limited_liability_company), [unlimited companies](http://en.wikipedia.org/wiki/Unlimited_company), or other names, depending on where and how they are organized. In the United States, but not generally in the United Kingdom, the term is also extended to [partnerships](http://en.wikipedia.org/wiki/Partnerships), [sole proprietorships](http://en.wikipedia.org/wiki/Sole_proprietorship) or business trusts. Each of these categories may have additional requirements and restrictions that may impact reporting requirements, income tax liabilities, governmental obligations, employee relations, marketing opportunities, and other business decisions.

In many countries, there are forms of organization which are restricted to and are commonly used by private companies, for example the [private company limited by shares](http://en.wikipedia.org/wiki/Private_company_limited_by_shares) in the United Kingdom (abbreviated *Ltd*) or [private unlimited company](http://en.wikipedia.org/wiki/Unlimited_company) and the [proprietary limited company](http://en.wikipedia.org/wiki/Proprietary_limited_company) (abbreviated *Pty Ltd*) or [unlimited proprietary company](http://en.wikipedia.org/wiki/Unlimited_company) (abbreviated *Pty*) in Australia.

**Reporting obligations and restrictions**

Privately held companies generally have fewer or less comprehensive reporting requirements for [transparency](http://en.wikipedia.org/wiki/Transparency_(humanities)), via annual reports, etc. than do publicly traded companies. For example, in the United States, unlike in Europe, privately held companies are not generally required to publish their [financial statements](http://en.wikipedia.org/wiki/Financial_statements). By not being required to disclose details about their operations and financial outlook, private companies are not forced to disclose information that may potentially be valuable to competitors and can avoid the immediate erosion of customer and stakeholder confidence in the event of financial duress. Further, with limited reporting requirements and shareholder expectations, private firms are afforded a greater operational flexibility by being able to focus on long term growth rather than quarterly earnings. In addition, private company executives may steer their ships without shareholder approval, allowing them to take significant action without haste.[[2]](http://en.wikipedia.org/wiki/Privately_held_company#cite_note-PrivCo-1)[[3]](http://en.wikipedia.org/wiki/Privately_held_company#cite_note-Library-2) In [Australia](http://en.wikipedia.org/wiki/Australia), Part 2E of the [Corporations Act 2001](http://en.wikipedia.org/wiki/Corporations_Act_2001) requires that publicly traded companies file certain documents relating to their [annual general meeting](http://en.wikipedia.org/wiki/Annual_general_meeting) with the [Australian Securities and Investments Commission](http://en.wikipedia.org/wiki/Australian_Securities_and_Investments_Commission), while there is no similar requirement for privately held companies.

Privately held companies also sometimes have restrictions on how many [shareholders](http://en.wikipedia.org/wiki/Shareholders) they may have. For example, the U.S. [Securities Exchange Act of 1934](http://en.wikipedia.org/wiki/Securities_Exchange_Act_of_1934), section 12(g), limits a privately held company, generally, to fewer than 500 shareholders, and the U.S. [Investment Company Act of 1940](http://en.wikipedia.org/wiki/Investment_Company_Act_of_1940), requires registration of investment companies that have more than 100 holders. In Australia, section 113 of the Corporations Act 2001 limits a privately held company to fifty non-employee shareholders.

**Privately owned enterprise**

A **privately owned enterprise** refers to a commercial enterprise that is owned by private investors, shareholders or owners (usually [collectively](http://en.wikipedia.org/wiki/Corporation), but they can be owned by a [single individual](http://en.wikipedia.org/wiki/Sole_proprietorship)), and is in contrast to state institutions, such as [publicly owned enterprises](http://en.wikipedia.org/wiki/State_Enterprise) and [government agencies](http://en.wikipedia.org/wiki/Government_agencies). Private enterprises comprise the [private sector](http://en.wikipedia.org/wiki/Private_sector) of an economy. An economic system that contains a large private sector where privately run businesses are the backbone of the economy is referred to as capitalism. This contrasts with [socialism](http://en.wikipedia.org/wiki/Socialism), where industry is owned by the [state](http://en.wikipedia.org/wiki/Public_sector) or by all of the community in common. The act of taking assets into the private sector is referred to as [privatization](http://en.wikipedia.org/wiki/Privatization). The goal of private enterprise differs from other institutions, the major difference being private businesses exist solely to generate profit for the owners or shareholders.[[4]](http://en.wikipedia.org/wiki/Privately_held_company#cite_note-3)

A privately owned enterprise is one form that [private property](http://en.wikipedia.org/wiki/Private_property) may take.

Types of privately owned business

* **Sole proprietorship:** A [sole proprietorship](http://en.wikipedia.org/wiki/Sole_proprietorship) is a business owned by one person. The owner may operate on his or her own or may employ others. The owner of the business has total and unlimited personal [liability](http://en.wikipedia.org/wiki/Legal_liability) of the debts incurred by the business. This form is usually relegated to small businesses.
* **Partnership:** A [partnership](http://en.wikipedia.org/wiki/Partnership) is a form of business in which two or more people operate for the common goal of making profit. Each partner has total and unlimited personal liability of the debts incurred by the partnership. There are three typical classifications of partnerships: [general partnerships](http://en.wikipedia.org/wiki/General_partnership), [limited partnerships](http://en.wikipedia.org/wiki/Limited_partnership), and [limited liability partnerships](http://en.wikipedia.org/wiki/Limited_liability_partnership).
* **Corporation:** A business [corporation](http://en.wikipedia.org/wiki/Corporation) is a for-profit, [limited liability](http://en.wikipedia.org/wiki/Limited_liability) or [unlimited liability](http://en.wikipedia.org/wiki/Unlimited_company) entity that has a separate [legal personality](http://en.wikipedia.org/wiki/Legal_personality) from its members. A corporation is owned by multiple [shareholders](http://en.wikipedia.org/wiki/Shareholder) and is overseen by a [board of directors](http://en.wikipedia.org/wiki/Board_of_directors), which hires the business's managerial staff. Corporate models have also been applied to the state sector in the form of [Government-owned corporations](http://en.wikipedia.org/wiki/State_Enterprise). A corporation may be privately held (that is, close - that is, held by a few people) or publicly traded.

Privately owned businesses are typically divided into two subcategories: [privately held](http://en.wikipedia.org/wiki/Privately_held) companies and [publicly traded companies](http://en.wikipedia.org/wiki/Publicly_traded_companies). Publicly traded firms list their shares on the stock market, allowing for more diversified ownership as anyone who purchases their stock becomes a partial owner and is able to receive a portion of its profit. Despite the term "public" in its name, a publicly listed company does not entail [public ownership](http://en.wikipedia.org/wiki/Public_ownership) because it is not owned by the whole society. It just means that shares of the company are for sale to anyone in the general public who wishes to purchase them. Publicly listed corporations may be partially owned by peacemakers.

Criticism

Criticism of private business has come from many perspectives, most notably[socialist](http://en.wikipedia.org/wiki/Socialist) perspectives. Criticism of private property and privately owned business is usually accompanied by criticism of the capitalist system entirely. Socialists often arguethat within a capitalist system, economic activity is uncoordinated and serves the interest of a small business class as opposed to society as a whole. This results in stifled advancementand an 'anarchy of production'. [Marxists](http://en.wikipedia.org/wiki/Marxists) criticize private businessalong with capitalism, as being a form of [exploitation](http://en.wikipedia.org/wiki/Exploitation) that serves to extract the surplus value from the workforce and distribute it to passive owners (the capitalist class) in the form of [profit](http://en.wikipedia.org/wiki/Profit_(accounting)). Because of this exploitation, the workers do not receive the full product of their labor and are forced, by the conditions imposed upon them by capitalism, to sell their labor to business owners in order to make a living. Socialists typically arguefor public ownership of the means of production, with Marxian socialists advocating more direct collective worker-ownership of business enterprises with democratic worker management. Other critics of private property include[technocrats](http://en.wikipedia.org/wiki/Technocracy), some forms of [economic nationalism](http://en.wikipedia.org/wiki/Economic_nationalism), [anarchists](http://en.wikipedia.org/wiki/Anarchists) and proponents of [economic democracy](http://en.wikipedia.org/wiki/Economic_democracy), who believe power and economic decision-making should be spread among as many people as opposed to being concentrated into the hands of a few.

India

In [India](http://en.wikipedia.org/wiki/India), the term **private limited** (abbreviated: Pvt. Ltd.) is used after a name of a company which is privately held unlike public companies which use the word **limited** only.

## Tariffs

**What Is a Tariff?**In simplest terms, a [tariff](http://www.investopedia.com/terms/t/tariff.asp) is a tax. It adds to the cost of imported goods and is one of several trade policies that a country can enact.   
**Why Are Tariffs and Trade Barriers Used?**Tariffs are often created to protect [infant industries](http://www.investopedia.com/terms/e/emergingindustry.asp) and developing economies, but are also used by more advanced economies with developed industries. Here are five of the top reasons tariffs are used:

**1. Protecting Domestic Employment**The levying of tariffs is often highly politicized. The possibility of increased competition from imported goods can threaten domestic industries. These domestic companies may fire workers or shift production abroad to cut costs, which means higher [unemployment](http://www.investopedia.com/terms/u/unemploymentrate.asp) and a less happy electorate. The unemployment argument often shifts to domestic industries complaining about cheap foreign labour, and how poor working conditions and lack of regulation allow foreign companies to produce goods more cheaply. In economics, however, countries will continue to produce goods until they no longer have a [comparative advantage](http://www.investopedia.com/terms/c/comparativeadvantage.asp) (not to be confused with an [absolute advantage](http://www.investopedia.com/terms/a/absoluteadvantage.asp)).   
**2. Protecting Consumers**A government may levy a tariff on products that it feels could endanger its population. For example, South Korea may place a tariff on imported beef from the United States if it thinks that the goods could be tainted with disease.  
**3. Infant Industries**The use of tariffs to protect infant industries can be seen by the Import Substitution Industrialization (ISI) strategy employed by many developing nations. The government of a developing economy will levy tariffs on imported goods in industries in which it wants to foster growth. This increases the prices of imported goods and creates a domestic market for domestically produced goods, while protecting those industries from being forced out by more competitive pricing. It decreases unemployment and allows developing countries to shift from agricultural products to finished goods.  
Criticisms of this sort of [protectionist](http://www.investopedia.com/terms/p/protectionism.asp) strategy revolve around the cost of [subsidizing](http://www.investopedia.com/terms/s/subsidy.asp) the development of infant industries. If an industry develops without competition, it could wind up producing lower quality goods, and the subsidies required to keep the state-backed industry afloat could sap economic growth.  
**4. National Security**[Barriers](http://www.investopedia.com/terms/b/barrierstoentry.asp) are also employed by developed countries to protect certain industries that are deemed strategically important, such as those supporting national security. Defence industries are often viewed as vital to state interests, and often enjoy significant levels of protection. For example, while both Western Europe and the United States are industrialized, both are very protective of defence-oriented companies.  
**5. Retaliation**Countries may also set tariffs as a retaliation technique if they think that a trading partner has not played by the rules. For example, if France believes that the United States has allowed its wine producers to call its domestically produced sparkling wines "Champagne" (a name specific to the Champagne region of France) for too long, it may levy a tariff on imported meat from the United States. If the U.S. agrees to crack down on the improper labelling, France is likely to stop its retaliation. Retaliation can also be employed if a trading partner goes against the government's foreign policy objectives.  
Read more: <http://www.investopedia.com/articles/economics/08/tariff-trade-barrier-basics.asp#ixzz1wvQF3Wzh>

## Barriers to entry

In theories of [competition](http://en.wikipedia.org/wiki/Competition_(economics)) in [economics](http://en.wikipedia.org/wiki/Economics), **barriers to entry**, also known as **barrier to entry**, are obstacles that make it difficult to enter a given [market](http://en.wikipedia.org/wiki/Market).The term can refer to hindrances a firm faces in trying to enter a market or [industry](http://en.wikipedia.org/wiki/Industry) - such as government [regulation](http://en.wikipedia.org/wiki/Regulation), or a large, established firm taking advantage of [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale) - or those an individual faces in trying to gain entrance to a profession - such as education or [licensing](http://en.wikipedia.org/wiki/Licensing) requirements.

Because barriers to entry protect incumbent firms and restrict competition in a market, they can contribute to distortionary prices. The existence of [monopolies](http://en.wikipedia.org/wiki/Monopolies) or [market power](http://en.wikipedia.org/wiki/Market_power) is often aided by barriers to entry.

## Customs union

A **customs union** is a type of [trade bloc](http://en.wikipedia.org/wiki/Trade_bloc) which is composed of a [free trade area](http://en.wikipedia.org/wiki/Free_trade_area) with a [common external tariff](http://en.wikipedia.org/wiki/Common_external_tariff). The participant countries set up common [external trade](http://en.wikipedia.org/wiki/External_trade) policy, but in some cases they use different import [quotas](http://en.wikipedia.org/wiki/Import_quota). Common [competition policy](http://en.wikipedia.org/wiki/Competition_policy) is also helpful to avoid [competition](http://en.wikipedia.org/wiki/Competition) deficiency.

Purposes for establishing a customs union normally include increasing [economic efficiency](http://en.wikipedia.org/wiki/Economic_efficiency) and establishing closer political and cultural ties between the member countries.

It is the third stage of [economic integration](http://en.wikipedia.org/wiki/Economic_integration).

Customs unions are established through [trade pacts](http://en.wikipedia.org/wiki/Trade_pact).

## Import

The term **import** is derived from the conceptual meaning as to bring in the goods and services into the port of a country. The buyer of such goods and services is referred to an "importer" who is based in the country of import whereas the overseas based seller is referred to as an "exporter". Thus an import is any [good](http://en.wikipedia.org/wiki/Good_(economics_and_accounting)) (e.g. a [commodity](http://en.wikipedia.org/wiki/Commodity)) or [service](http://en.wikipedia.org/wiki/Service_(economics)) brought in from one country to another country in a legitimate fashion, typically for use in [trade](http://en.wikipedia.org/wiki/Trade). It is a good that is brought in from another country for sale. Import goods or services are provided to domestic [consumers](http://en.wikipedia.org/wiki/Consumer) by foreign [producers](http://en.wikipedia.org/wiki/Production,_costs,_and_pricing). An import in the receiving country is an [export](http://en.wikipedia.org/wiki/Export) to the sending country.

Imports, along with [exports](http://en.wikipedia.org/wiki/Exports), form the basis of [international trade](http://en.wikipedia.org/wiki/International_trade). Import of goods normally requires involvement of the [customs](http://en.wikipedia.org/wiki/Customs) authorities in both the country of import and the country of [export](http://en.wikipedia.org/wiki/Export) and are often subject to [import quotas](http://en.wikipedia.org/wiki/Import_quota), [tariffs](http://en.wikipedia.org/wiki/Tariff) and [trade agreements](http://en.wikipedia.org/wiki/Trade_agreements). When the "imports" are the set of goods and services imported, "Imports" also means the [economic value](http://en.wikipedia.org/wiki/Value_(economics)) of all goods and services that are imported. The [macroeconomic](http://en.wikipedia.org/wiki/Macroeconomics) variable usually stands for the value of these imports over a given period of time, usually one year.

## Export

This term **export** is derived from the conceptual meaning as to ship the goods and services out of the port of a country. The seller of such goods and services is referred to as an "exporter" who is based in the country of export whereas the overseas based buyer is referred to as an "importer". In International Trade, "exports" refers to selling goods and services produced in the home country to other markets.

Any [good](http://en.wikipedia.org/wiki/Good_(economics_and_accounting)) or [commodity](http://en.wikipedia.org/wiki/Commodity), [transported](http://en.wikipedia.org/wiki/Transport) from one country to another country in a legitimate fashion, typically for use in [trade](http://en.wikipedia.org/wiki/Trade). Export goods or services are provided to foreign [consumers](http://en.wikipedia.org/wiki/Consumer) by domestic [producers](http://en.wikipedia.org/wiki/Production_theory_basics).

Export of commercial quantities of goods normally requires involvement of the customs authorities in both the country of export and the country of import. The advent of small trades over the internet such as through [Amazon](http://en.wikipedia.org/wiki/Amazon.com) and [eBay](http://en.wikipedia.org/wiki/EBay) have largely bypassed the involvement of Customs in many countries because of the low individual values of these trades. Nonetheless, these small exports are still subject to legal restrictions applied by the country of export. An export's counterpart is an [import](http://en.wikipedia.org/wiki/Import).

## Foreign direct investment

**Foreign direct investment** (**FDI**) is direct investment into production in a country by a company located in another country, either by buying a company in the country or by expanding operations of an existing business in the country. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as [tax exemptions](http://en.wikipedia.org/wiki/Tax_exemption) offered by the country as an incentive to gain tariff-free access to the markets of the country or the region. Foreign direct investment is in contrast to [portfolio investment](http://en.wikipedia.org/wiki/Portfolio_investment) which is a passive investment in the securities of another country such as [stocks](http://en.wikipedia.org/wiki/Stocks) and [bonds](http://en.wikipedia.org/wiki/Bond_(finance)).

As a part of the [national accounts](http://en.wikipedia.org/wiki/National_accounts) of a country FDI refers to the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor.[  It is the sum of [equity capital](http://en.wikipedia.org/wiki/Equity_capital), other long-term capital, and short-term capital as shown the [balance of payments](http://en.wikipedia.org/wiki/Balance_of_payments). It usually involves participation in management, [joint-venture](http://en.wikipedia.org/wiki/Joint-venture), [transfer of technology](http://en.wikipedia.org/wiki/Transfer_of_technology) and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a *net* FDI *inflow* (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes [investment through purchase of shares](http://en.wikipedia.org/wiki/Foreign_portfolio_investment).[[4]](http://en.wikipedia.org/wiki/Direct_investment#cite_note-3) FDI is one example of [international factor movements](http://en.wikipedia.org/wiki/International_factor_movements).

## Stock

The **capital stock** (or simply **stock**) of a business entity represents the original capital paid into or invested in the business by its founders. It serves as a [security](http://en.wikipedia.org/wiki/Security_(finance)) for the [creditors](http://en.wikipedia.org/wiki/Creditor) of a business since it cannot be withdrawn to the detriment of the creditors. Stock is different from the property and the assets of a business which may fluctuate in quantity and value.

## Bond

In [finance](http://en.wikipedia.org/wiki/Finance), a **bond** is a debt [security](http://en.wikipedia.org/wiki/Security_(finance)), in which the authorized issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay [interest](http://en.wikipedia.org/wiki/Interest) (the [coupon](http://en.wikipedia.org/wiki/Coupon_(bond))) to use and/or to repay the principal at a later date, termed [maturity](http://en.wikipedia.org/wiki/Maturity_(finance)). A bond is a formal [contract](http://en.wikipedia.org/wiki/Contract) to repay borrowed money with interest at fixed intervals (semi annual, annual, sometimes monthly).

Thus a bond is like a [loan](http://en.wikipedia.org/wiki/Loan): the *holder* of the bond is the lender (creditor), the *issuer* of the bond is the borrower (debtor), and the *coupon* is the interest. Bonds provide the borrower with external funds to finance long-term [investments](http://en.wikipedia.org/wiki/Investment), or, in the case of [government bonds](http://en.wikipedia.org/wiki/Government_bond), to finance current expenditure. [Certificates of deposit](http://en.wikipedia.org/wiki/Certificate_of_deposit) (CDs) or [commercial paper](http://en.wikipedia.org/wiki/Commercial_paper) are considered to be [money market](http://en.wikipedia.org/wiki/Money_market) instruments and not bonds.

Bonds and [stocks](http://en.wikipedia.org/wiki/Stock) are both [securities](http://en.wikipedia.org/wiki/Security_(finance)), but the major difference between the two is that (capital) stockholders have an [equity](http://en.wikipedia.org/wiki/Equity_(finance)) stake in the company (i.e., they are owners), whereas bondholders have a creditor stake in the company (i.e., they are lenders). Another difference is that bonds usually have a defined term, or maturity, after which the bond is redeemed, whereas stocks may be outstanding indefinitely. An exception is a [consol bond](http://en.wikipedia.org/wiki/Consols), which is a [perpetuity](http://en.wikipedia.org/wiki/Perpetuity) (i.e., bond with no maturity).

In the UK, "bond" is also used to refer to a [time deposit](http://en.wikipedia.org/wiki/Time_deposit) with a bank or building society, which in general is not marketable and is subject to different tax treatment from the bonds discussed here.

## Multinational Corporation

A **multinational corporation** (MNC) or **multinational enterprise** (MNE)is a [corporation](http://en.wikipedia.org/wiki/Corporation) enterprise that manages [production](http://en.wikipedia.org/wiki/Production,_costs,_and_pricing) or delivers [services](http://en.wikipedia.org/wiki/Service_(economics)) in more than one country. It can also be referred to as an **international corporation**. They play an important role in [globalization](http://en.wikipedia.org/wiki/Globalization).

## Strategies

Corporations may make a [foreign direct investment](http://en.wikipedia.org/wiki/Foreign_direct_investment). Foreign direct investment is direct investment into one country by a company in production located in another country either by buying a company in the country or by expanding operations of an existing business in the country.

A [subsidiary](http://en.wikipedia.org/wiki/Subsidiary) or daughter company is a [company](http://en.wikipedia.org/wiki/Company_(law)) that is completely or partly owned and wholly controlled by another company that owns more than half of the subsidiary's [stock](http://en.wikipedia.org/wiki/Stock).

A corporation may choose to locate in a [special economic zone](http://en.wikipedia.org/wiki/Special_economic_zone), which is a geographical region that has economic and other laws that are more free-market-oriented than a country's typical or national laws.

## Globalization

**Globalization** (or **globalisation**) refers to the process or processes of international integration. Human interaction over long distances has existed for thousands of years. The overland [Silk Road](http://en.wikipedia.org/wiki/Silk_Road) that connected [Asia](http://en.wikipedia.org/wiki/Asia), [Africa](http://en.wikipedia.org/wiki/Africa) and [Europe](http://en.wikipedia.org/wiki/Europe) is a good example of the transformative power of international exchange. Philosophy, religions, language, arts, and other aspects of culture spread and mixed as nations exchanged products and ideas. In the 15th and 16th centuries, Europeans made important discoveries in their exploration of the [World Ocean](http://en.wikipedia.org/wiki/World_ocean) and in beginning cross-Atlantic travel to the "[New World](http://en.wikipedia.org/wiki/New_World)" of the [Americas](http://en.wikipedia.org/wiki/Americas). Global movement of people, goods, and ideas expanded significantly in the following centuries. Early in the 19th century, the development of new forms of transportation (such as the [steamship](http://en.wikipedia.org/wiki/Steamship) and [railroads](http://en.wikipedia.org/wiki/Railroads)) and [telecommunications](http://en.wikipedia.org/wiki/Telecommunication) that "compressed" time and space allowed for increasingly rapid rates of global interchange. In the 20th century, [road vehicles](http://en.wikipedia.org/wiki/Road_vehicle) and [airlines](http://en.wikipedia.org/wiki/Airline) made transportation even faster, and the advent of electronic communications, most notably [mobile phones](http://en.wikipedia.org/wiki/Mobile_phones) and [the Internet](http://en.wikipedia.org/wiki/The_Internet), connected billions of people in new ways leading into the [21st century](http://en.wikipedia.org/wiki/21st_century).

## OPEC

The **Organization of the Petroleum Exporting Countries**  is an intergovernmental organization of twelve oil-producing countries made up of  [Algeria](http://en.wikipedia.org/wiki/Algeria),  [Angola](http://en.wikipedia.org/wiki/Angola),  [Ecuador](http://en.wikipedia.org/wiki/Ecuador),  [Iran](http://en.wikipedia.org/wiki/Iran), [Iraq](http://en.wikipedia.org/wiki/Iraq),  [Kuwait](http://en.wikipedia.org/wiki/Kuwait),  [Libya](http://en.wikipedia.org/wiki/Libya),  [Nigeria](http://en.wikipedia.org/wiki/Nigeria), [Qatar](http://en.wikipedia.org/wiki/Qatar), [Saudi Arabia](http://en.wikipedia.org/wiki/Saudi_Arabia), the [United Arab Emirates](http://en.wikipedia.org/wiki/United_Arab_Emirates), and [Venezuela](http://en.wikipedia.org/wiki/Venezuela). OPEC has maintained its headquarters in [Vienna](http://en.wikipedia.org/wiki/Vienna) since 1965,and hosts regular meetings among the oil ministers of its Member Countries. [Indonesia](http://en.wikipedia.org/wiki/Indonesia) withdrew in 2008 after it became a net importer of oil, but stated it would likely return if it became a net exporter again.

According to its [statutes](http://en.wikipedia.org/wiki/Statutes), one of the principal goals is the determination of the best means for safeguarding the organization's interests, individually and collectively. It also pursues ways and means of ensuring the stabilization of prices in international [oil markets](http://en.wikipedia.org/wiki/Oil_industry) with a view to eliminating harmful and unnecessary fluctuations; giving due regard at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries; an efficient and regular supply of [petroleum](http://en.wikipedia.org/wiki/Petroleum) to consuming nations, and a fair return on their capital to those investing in the petroleum industry.

OPEC's influence on the market has been widely criticized, since it became effective in determining production and prices. Arab members of OPEC alarmed the developed world when they used the “oil weapon” during the [Yom Kippur War](http://en.wikipedia.org/wiki/Yom_Kippur_War) by implementing oil embargoes and initiating the [1973 oil crisis](http://en.wikipedia.org/wiki/1973_oil_crisis). Although largely political explanations for the timing and extent of the OPEC price increases are also valid, from OPEC’s point of viewthese changes were triggered largely by previous [unilateral changes](http://en.wikipedia.org/wiki/Nixon_shock) in the world financial system and the ensuing period of high inflation in both the developed and developing world. This explanation encompasses OPEC actions both before and after the outbreak of hostilities in October 1973, and concludes that “OPEC countries were only 'staying even' by dramatically raising the dollar price of oil.”

OPEC's ability to control the [price of oil](http://en.wikipedia.org/wiki/Price_of_oil) has diminished somewhat since then, due to the subsequent discovery and development of large [oil reserves](http://en.wikipedia.org/wiki/Oil_reserves) in [Alaska](http://en.wikipedia.org/wiki/Alaska), the [North Sea](http://en.wikipedia.org/wiki/North_Sea), [Canada](http://en.wikipedia.org/wiki/Canada), the [Gulf of Mexico](http://en.wikipedia.org/wiki/Gulf_of_Mexico), the opening up of Russia, and market modernization. As of November 2010, OPEC members collectively hold 79% of world crude oil reserves and 44% of the world’s crude oil production capacity, affording them some control over the global market. The next largest group of producers, members of the [OECD](http://en.wikipedia.org/wiki/OECD) and the [Post-Soviet states](http://en.wikipedia.org/wiki/Post-Soviet_states) produced only 23.8% and 14.8%, respectively, of the world's total oil production. As early as 2003, concerns that OPEC members had little excess pumping capacity sparked speculation that their influence on crude oil prices would begin to slip.

# VI Money, Central Bank and Monetary Policy

## Federal Reserve System

The **Federal Reserve System** (also known as the **Federal Reserve**, and informally as the **Fed**) is the [central banking](http://en.wikipedia.org/wiki/Central_bank) system of the United States. It was created on December 23, 1913 with the enactment of the [Federal Reserve Act](http://en.wikipedia.org/wiki/Federal_Reserve_Act). Over time, the roles and responsibilities of the Federal Reserve System have expanded and its structure has evolved. Events such as the [Great Depression](http://en.wikipedia.org/wiki/Great_Depression) were major factors leading to changes in the system.

The Congress established three key objectives for monetary policy—maximum employment, stable prices, and moderate long-term interest rates—in the Federal Reserve Act.  The first two objectives are sometimes referred to as the Federal Reserve's dual mandate. Its duties have expanded over the years, and today, according to official Federal Reserve documentation, include conducting the nation's [monetary policy](http://en.wikipedia.org/wiki/Monetary_policy), supervising and regulating banking institutions, maintaining the stability of the financial system and providing financial services to [depository institutions](http://en.wikipedia.org/wiki/Depository_institution), the U.S. government, and foreign official institutions. The Fed also conducts research into the economy and releases numerous publications, such as the [Beige Book](http://en.wikipedia.org/wiki/Beige_Book).

The Federal Reserve System's structure is composed of the presidentially appointed [Board of Governors](http://en.wikipedia.org/wiki/Federal_Reserve_Board_of_Governors) (or Federal Reserve Board), the [Federal Open Market Committee](http://en.wikipedia.org/wiki/Federal_Open_Market_Committee) (FOMC), twelve regional [Federal Reserve Banks](http://en.wikipedia.org/wiki/Federal_Reserve_Bank) located in major cities throughout the nation, numerous privately owned U.S. member banks and various advisory councils. The FOMC is the committee responsible for setting monetary policy and consists of all seven members of the Board of Governors and the twelve regional bank presidents, though only five bank presidents vote at any given time. The Federal Reserve System has both private and public components, and was designed to serve the interests of both the general public and private bankers. The result is a structure that is considered unique among central banks. It is also unusual in that an entity outside of the central bank, namely the [United States Department of the Treasury](http://en.wikipedia.org/wiki/United_States_Department_of_the_Treasury), creates the [currency](http://en.wikipedia.org/wiki/Currency) used.[

According to the Board of Governors, the Federal Reserve is independent within government in that "its monetary policy decisions do not have to be approved by the President or anyone else in the executive or legislative branches of government." Its authority is derived from statutes enacted by the [U.S. Congress](http://en.wikipedia.org/wiki/U.S._Congress) and the System is subject to congressional oversight. The members of the Board of Governors, including its chairman and vice-chairman, are chosen by the [President](http://en.wikipedia.org/wiki/President_of_the_United_States) and confirmed by the Senate. The government also exercises some control over the Federal Reserve by appointing and setting the salaries of the system's highest-level employees. Thus the Federal Reserve has both private and public aspects. The U.S. Government receives all of the system's annual profits, after a statutory [dividend](http://en.wikipedia.org/wiki/Dividend) of 6% on member banks' capital investment is paid, and an account surplus is maintained. In 2010, the Federal Reserve made a profit of $82 billion and transferred $79 billion to the [U.S. Treasury](http://en.wikipedia.org/wiki/U.S._Treasury). This was followed at the end of 2011 with a transfer of $77 billion in profits to the U.S. Treasury Department.

## Fiscal policy

In [economics](http://en.wikipedia.org/wiki/Economics) and [political science](http://en.wikipedia.org/wiki/Political_science), **fiscal policy** is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy. The two main instruments of fiscal policy are government taxation and expenditure. Changes in the level and composition of taxation and government spending can impact the following variables in the economy:

* [Aggregate demand](http://en.wikipedia.org/wiki/Aggregate_demand) and the level of economic activity;
* The pattern of resource allocation;
* The distribution of income.

Fiscal policy refers to the use of the government budget to influence economic activity.

### Methods of funding

Governments [spend money](http://en.wikipedia.org/wiki/Government_expenditure) on a wide variety of things, from the military and police to services like education and healthcare, as well as [transfer payments](http://en.wikipedia.org/wiki/Transfer_payment) such as welfare benefits. This expenditure can be [funded](http://en.wikipedia.org/wiki/Revenue) in a number of different ways:

* [Taxation](http://en.wikipedia.org/wiki/Taxation)
* [Seigniorage](http://en.wikipedia.org/wiki/Seigniorage), the benefit from printing [money](http://en.wikipedia.org/wiki/Money)
* [Borrowing](http://en.wikipedia.org/wiki/Borrowing) money from the population or from abroad
* [Consumption](http://en.wikipedia.org/wiki/Consumption) of fiscal reserves
* [Sale](http://en.wikipedia.org/wiki/Sale) of fixed assets (e.g., [land](http://en.wikipedia.org/wiki/Land))

## Income

**Income** is the consumption and savings opportunity gained by an entity within a specified time frame, which is generally expressed in monetary terms. However, for households and individuals, "income is the sum of all the wages, salaries, profits, interests payments, rents and other forms of earnings received... in a given period of time." For firms, income generally refers to net-profit: what remains of [revenue](http://en.wikipedia.org/wiki/Revenue) after expenses have been subtracted. In the field of [public economics](http://en.wikipedia.org/wiki/Public_economics), it may refer to the accumulation of both monetary and non-monetary consumption ability, the former being used as a proxy for total income.

## Tax

To **tax** is to impose a financial charge or other levy upon a **taxpayer** (an individual or [legal entity](http://en.wikipedia.org/wiki/Legal_person)) by a [state](http://en.wikipedia.org/wiki/State_(polity)) or the functional equivalent of a state such that failure to pay is punishable by law. Taxes are also imposed by many [administrative divisions](http://en.wikipedia.org/wiki/Administrative_division). Taxes consist of [direct tax](http://en.wikipedia.org/wiki/Direct_tax) or [indirect tax](http://en.wikipedia.org/wiki/Indirect_tax), and may be paid in [money](http://en.wikipedia.org/wiki/Money) or as its labour equivalent (often but not always unpaid labour).

## Value added tax

A **value added tax** (**VAT**) is a form of [consumption tax](http://en.wikipedia.org/wiki/Consumption_tax). From the perspective of the buyer, it is a tax on the purchase price. From that of the seller, it is a tax only on the [value added](http://en.wikipedia.org/wiki/Value_added) to a product, material or service, from an accounting point of view, by this stage of its manufacture or distribution. The manufacturer remits to the government the difference between these two amounts, and retains the rest for themselves to offset the taxes they had previously paid on the inputs.

The value added to a product by a business is the sale price charged to its customer, minus the cost of materials and other taxable inputs. A VAT is like a [sales tax](http://en.wikipedia.org/wiki/Sales_tax) in that ultimately only the end consumer is taxed. It differs from the sales tax in that, with the latter, the tax is collected and remitted to the government only once, at the point of purchase by the end consumer. With the VAT, collections, remittances to the government, and credits for taxes already paid occur each time a business in the supply chain purchases products.

## European Union

The **European Union** (**EU**)  is an [economic](http://en.wikipedia.org/wiki/Economic_and_Monetary_Union_of_the_European_Union) and political union or [confederation](http://en.wikipedia.org/wiki/Confederation#European_Union) of 27 [member states](http://en.wikipedia.org/wiki/Member_state_of_the_European_Union) which are located primarily in [Europe](http://en.wikipedia.org/wiki/Europe). The EU traces its origins from the [European Coal and Steel Community](http://en.wikipedia.org/wiki/European_Coal_and_Steel_Community) (ECSC) and the [European Economic Community](http://en.wikipedia.org/wiki/European_Economic_Community) (EEC), formed by [six countries](http://en.wikipedia.org/wiki/Inner_Six) in 1958. In the intervening years the EU has grown in size by [the accession of new member states](http://en.wikipedia.org/wiki/Enlargement_of_the_European_Union) and in power by the addition of policy areas to its remit. The [Maastricht Treaty](http://en.wikipedia.org/wiki/Maastricht_Treaty) established the European Union under its current name in 1993. The latest amendment to the constitutional basis of the EU, the [Treaty of Lisbon](http://en.wikipedia.org/wiki/Treaty_of_Lisbon), came into force in 2009.

The EU operates through a system of [supranational](http://en.wikipedia.org/wiki/Supranational_union) independent institutions and [intergovernmental](http://en.wikipedia.org/wiki/Intergovernmentalism) negotiated decisions by the member states. Important [institutions of the EU](http://en.wikipedia.org/wiki/Institutions_of_the_European_Union) include the [European Commission](http://en.wikipedia.org/wiki/European_Commission), the [Council of the European Union](http://en.wikipedia.org/wiki/Council_of_the_European_Union), the [European Council](http://en.wikipedia.org/wiki/European_Council), the [Court of Justice of the European Union](http://en.wikipedia.org/wiki/Court_of_Justice_of_the_European_Union), and the [European Central Bank](http://en.wikipedia.org/wiki/European_Central_Bank). The [European Parliament](http://en.wikipedia.org/wiki/European_Parliament) is elected every five years by [EU citizens](http://en.wikipedia.org/wiki/Citizenship_of_the_European_Union).

The EU has developed a [single market](http://en.wikipedia.org/wiki/Single_market) through a standardized system of laws which apply in all member states. Within the [Schengen Area](http://en.wikipedia.org/wiki/Schengen_Area) (which includes EU and non-EU states) passport controls have been abolished. EU policies aim to ensure the [free movement of people, goods, services, and capital](http://en.wikipedia.org/wiki/Internal_Market_(European_Union)), enact legislation in justice and home affairs, and maintain common policies on trade, [agriculture](http://en.wikipedia.org/wiki/Common_Agricultural_Policy), [fisheries](http://en.wikipedia.org/wiki/Common_Fisheries_Policy) and [regional development](http://en.wikipedia.org/wiki/Regional_policy_of_the_European_Union). A monetary union, the [eurozone](http://en.wikipedia.org/wiki/Eurozone), was established in 1999 and, as of January 2012, is composed of 17 member states. Through the [Common Foreign and Security Policy](http://en.wikipedia.org/wiki/Common_Foreign_and_Security_Policy) the EU has developed a limited role in [external relations](http://en.wikipedia.org/wiki/Foreign_relations_of_the_European_Union) and [defence](http://en.wikipedia.org/wiki/Military_of_the_European_Union). Permanent [diplomatic missions](http://en.wikipedia.org/wiki/List_of_diplomatic_missions_of_the_European_Union) have been established around the world. The EU is represented at the [United Nations](http://en.wikipedia.org/wiki/European_Union_and_the_United_Nations), the [WTO](http://en.wikipedia.org/wiki/World_Trade_Organization), the [G8](http://en.wikipedia.org/wiki/European_Union_and_the_G8) and the [G-20](http://en.wikipedia.org/wiki/G-20_major_economies).



As of 2010, with a combined population of over 500 million inhabitants, or 7.3% of the world population, the EU generated a nominal GDP of 16.2 trillion US dollars (larger than any single country in the world), representing 20% of the global GDP when measured in terms of [purchasing power parity](http://en.wikipedia.org/wiki/Purchasing_power_parity).

The European Union is composed of 27 [sovereign](http://en.wikipedia.org/wiki/Sovereign_state) member states: [Austria](http://en.wikipedia.org/wiki/Austria), [Belgium](http://en.wikipedia.org/wiki/Belgium), [Bulgaria](http://en.wikipedia.org/wiki/Bulgaria), [Cyprus](http://en.wikipedia.org/wiki/Cyprus), the [Czech Republic](http://en.wikipedia.org/wiki/Czech_Republic), [Denmark](http://en.wikipedia.org/wiki/Denmark), [Estonia](http://en.wikipedia.org/wiki/Estonia), [Finland](http://en.wikipedia.org/wiki/Finland), [France](http://en.wikipedia.org/wiki/France), [Germany](http://en.wikipedia.org/wiki/Germany),[Greece](http://en.wikipedia.org/wiki/Greece), [Hungary](http://en.wikipedia.org/wiki/Hungary), [Ireland](http://en.wikipedia.org/wiki/Republic_of_Ireland), [Italy](http://en.wikipedia.org/wiki/Italy), [Latvia](http://en.wikipedia.org/wiki/Latvia), [Lithuania](http://en.wikipedia.org/wiki/Lithuania), [Luxembourg](http://en.wikipedia.org/wiki/Luxembourg), [Malta](http://en.wikipedia.org/wiki/Malta), the [Netherlands](http://en.wikipedia.org/wiki/Netherlands), [Poland](http://en.wikipedia.org/wiki/Poland), [Portugal](http://en.wikipedia.org/wiki/Portugal), [Romania](http://en.wikipedia.org/wiki/Romania), [Slovakia](http://en.wikipedia.org/wiki/Slovakia), [Slovenia](http://en.wikipedia.org/wiki/Slovenia), [Spain](http://en.wikipedia.org/wiki/Spain), [Sweden](http://en.wikipedia.org/wiki/Sweden), and the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom). The Union's membership has grown from the original [six founding states](http://en.wikipedia.org/wiki/Inner_Six)—Belgium, France, (then-[West) Germany](http://en.wikipedia.org/wiki/West_Germany), Italy, Luxembourg and the Netherlands—to the present day 27 by successive enlargements as countries acceded to the [treaties](http://en.wikipedia.org/wiki/Treaties_of_the_European_Union) and by doing so, pooled their sovereignty in exchange for representation in the institutions.

To join the EU a country must meet the [Copenhagen criteria](http://en.wikipedia.org/wiki/Copenhagen_criteria), defined at the 1993 Copenhagen European Council. These require a stable democracy that respects human rights and the [rule of law](http://en.wikipedia.org/wiki/Rule_of_law); a functioning [market economy](http://en.wikipedia.org/wiki/Market_economy) capable of competition within the EU; and the acceptance of the obligations of membership, including EU law. Evaluation of a country's fulfilment of the criteria is the responsibility of the European Council.

No member state has ever left the Union, although [Greenland](http://en.wikipedia.org/wiki/Greenland) (an [autonomous province](http://en.wikipedia.org/wiki/Autonomous_area) of Denmark) withdrew in 1985.[[50]](http://en.wikipedia.org/wiki/European_Union#cite_note-52) The [Lisbon Treaty](http://en.wikipedia.org/wiki/Treaty_of_Lisbon) now provides a clause dealing with how a member leaves the EU.[[51]](http://en.wikipedia.org/wiki/European_Union#cite_note-53)

[Croatia](http://en.wikipedia.org/wiki/Croatia) is expected to become the 28th member state of the EU on 1 July 2013 after a [referendum on EU membership](http://en.wikipedia.org/wiki/Croatian_European_Union_membership_referendum,_2012) was approved by Croatian voters on 22 January 2012. The Croatian accession treaty still has to be ratified by all current EU member states.

## Economic union

An **economic union** is a type of [trade bloc](http://en.wikipedia.org/wiki/Trade_bloc) which is composed of a [common market](http://en.wikipedia.org/wiki/Common_market) with a [customs union](http://en.wikipedia.org/wiki/Customs_union). The participant countries have both common policies on product regulation, [freedom of movement](http://en.wikipedia.org/wiki/Freedom_of_movement) of [goods](http://en.wikipedia.org/wiki/Good_(economics)), [services](http://en.wikipedia.org/wiki/Service_(economics)) and the [factors of production](http://en.wikipedia.org/wiki/Factors_of_production) ([capital](http://en.wikipedia.org/wiki/Capital_(economics)) and labour) and a common [external trade](http://en.wikipedia.org/wiki/External_trade) policy. The countries often share a common currency.

Purposes for establishing a economic union normally include increasing [economic efficiency](http://en.wikipedia.org/wiki/Economic_efficiency) and establishing closer political and cultural ties between the member countries. Economic union is established through [trade pact](http://en.wikipedia.org/wiki/Trade_pact).

## Competition Commission

## The role of the Competition Commission

The Competition Commission (CC) is an independent public body which conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries, ensuring healthy competition between companies in the UK for the benefit of companies, customers and the economy.

All of the CC’s inquiries are undertaken following a reference made by another authority, most often the [Office of Fair Trading](http://en.wikipedia.org/wiki/Office_of_Fair_Trading) (OFT) (which refers merger and market inquiries), or one of the sector regulators (which can refer markets within their sectoral jurisdictions or make regulatory references in relation to price controls and other licence modifications) or as a result of an appeal from a decision of one of the sector regulators.

# VII World Economy

The **world economy**, or **global economy**, generally refers to the [economy](http://en.wikipedia.org/wiki/Economy), which is based on economies of all of the world's [countries](http://en.wikipedia.org/wiki/Countries), national economies. Also global economy can be seen as the economy of [global society](http://en.wikipedia.org/wiki/Global_society) and national economies – as economies of local societies, making the global one. It can be evaluated in various kind of ways. For instance, depending on the model used, the valuation that is arrived at can be represented in a certain [currency](http://en.wikipedia.org/wiki/Currency), such as 2006 [US dollars](http://en.wikipedia.org/wiki/United_States_dollar) or 2005 [Euros](http://en.wikipedia.org/wiki/Euros).

It is inseparable from the [geography and ecology of Earth](http://en.wikipedia.org/wiki/Earth), and is therefore somewhat of a misnomer, since, while definitions and representations of the "world economy" vary widely, they must at a minimum exclude any consideration of resources or value based outside of the [Earth](http://en.wikipedia.org/wiki/Earth). For example, while attempts could be made to calculate the value of currently unexploited mining opportunities in unclaimed territory in [Antarctica](http://en.wikipedia.org/wiki/Antarctica), the same opportunities on [Mars](http://en.wikipedia.org/wiki/Mars) would not be considered a part of the world economy—even if currently exploited in some way—and could be considered of latent value only in the same way as uncreated [intellectual property](http://en.wikipedia.org/wiki/Intellectual_property), such as a previously unconceived invention.

Beyond the minimum standard of concerning value in production, use, and exchange on the planet Earth, definitions, representations, models, and valuations of the world economy vary widely.

It is common to limit questions of the world economy exclusively to [human economic activity](http://en.wikipedia.org/wiki/Economics), and the world economy is typically judged in monetary terms, even in cases in which there is no efficient market to help valuate certain goods or services, or in cases in which a lack of independent research or government cooperation makes establishing figures difficult. Typical examples are [illegal drugs](http://en.wikipedia.org/wiki/Illegal_drug_trade) and other [black market goods](http://en.wikipedia.org/wiki/Underground_economy), which by any standard are a part of the world economy, but for which there is by definition no legal market of any kind.

However, even in cases in which there is a clear and efficient market to establish a monetary value, economists do not typically use the current or official exchange rate to translate the monetary units of this market into a single unit for the world economy, since exchange rates typically do not closely reflect [worldwide](http://en.wikipedia.org/wiki/World) value, for example in cases where the volume or price of transactions is closely regulated by the government.

Rather, market valuations in a local currency are typically translated to a single monetary unit using the idea of [purchasing power](http://en.wikipedia.org/wiki/Purchasing_power_parity). This is the method used below, which is used for estimating worldwide economic activity in terms of [real](http://en.wikipedia.org/wiki/Purchasing_power_parity) [US dollars](http://en.wikipedia.org/wiki/United_States_dollar) or Euros. However, the world economy can be evaluated and expressed in many more ways. It is unclear, for example, how many of the world's [7.01 billion people](http://en.wikipedia.org/wiki/World_population) have most of their economic activity reflected in these valuations.

In 2011, the largest economies in the world with more than $2 trillion, €1.25 trillion by nominal GDP were the [United States](http://en.wikipedia.org/wiki/United_States), [China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China), [Japan](http://en.wikipedia.org/wiki/Japan), [Germany](http://en.wikipedia.org/wiki/Germany), [France](http://en.wikipedia.org/wiki/France), the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom), [Brazil](http://en.wikipedia.org/wiki/Brazil), and [Italy](http://en.wikipedia.org/wiki/Italy). The largest economies in the world with more than $2 trillion, €1.25 trillion by GDP (PPP) were the [United States](http://en.wikipedia.org/wiki/United_States), [China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China), [Japan](http://en.wikipedia.org/wiki/Japan), [India](http://en.wikipedia.org/wiki/India), [Germany](http://en.wikipedia.org/wiki/Germany), [Russia](http://en.wikipedia.org/wiki/Russia), the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom), [Brazil](http://en.wikipedia.org/wiki/Brazil), and [France](http://en.wikipedia.org/wiki/France).

## International Monetary Fund



The **International Monetary Fund** (**IMF**) is an [international organization](http://en.wikipedia.org/wiki/International_organization) that was created on July 22, 1944 at the [Bretton Woods Conference](http://en.wikipedia.org/wiki/Bretton_Woods_Conference) and came into existence on December 27, 1945 when 29 countries signed the Articles of Agreement. It originally had 45 members. The IMF's stated goal was to stabilize exchange rates and assist the reconstruction of the world’s international payment system post [World War II](http://en.wikipedia.org/wiki/World_War_II). Countries contribute money to a pool through a quota system from which countries with payment imbalances can borrow funds on a temporary basis. Through this activity and others such as surveillance of its members' economies and policies, the IMF works to improve the economies of its member countries.The IMF describes itself as “an organization of 188 countries (as of April 2012), working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty.” The organization's stated objectives are to promote international economic cooperation, [international trade](http://en.wikipedia.org/wiki/International_trade), employment, and exchange rate stability, including by making financial resources available to member countries to meet [balance of payments](http://en.wikipedia.org/wiki/Balance_of_payments) needs. Its headquarters are in [Washington, D.C.](http://en.wikipedia.org/wiki/Washington,_D.C.)

## World Trade Organization

The **World Trade Organization** (**WTO**) is an organization that intends to supervise and [liberalize](http://en.wikipedia.org/wiki/Free_trade) [international trade](http://en.wikipedia.org/wiki/International_trade). The organization officially commenced on January 1, 1995 under the [Marrakech Agreement](http://en.wikipedia.org/wiki/Marrakech_Agreement), replacing the [General Agreement on Tariffs and Trade](http://en.wikipedia.org/wiki/General_Agreement_on_Tariffs_and_Trade) (GATT), which commenced in 1948. The organization deals with regulation of trade between participating countries; it provides a framework for negotiating and formalizing trade agreements, and a dispute resolution process aimed at enforcing participants' adherence to WTO agreements which are signed by representatives of member governments and ratified by their [parliaments](http://en.wikipedia.org/wiki/Parliament)

## U.S. Securities and Exchange Commission

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The U.S. Securities and Exchange Commission (frequently abbreviated SEC) is a [federal agency](http://en.wikipedia.org/wiki/List_of_United_States_federal_agencies)which holds primary responsibility for enforcing the federal [securities](http://en.wikipedia.org/wiki/Security_(finance)) laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets in the United States.

## National Stock Exchange

The first stock exchange in America that was completely electronically automated. All members of the exchange are registered broker-dealers. This exchange created the National Securities Trading System (NSTS), which performs all auction market tasks on an automated basis.  
Read more: <http://www.investopedia.com/terms/n/national-stock-exchange.asp#ixzz1x1BJLUsw>

## North American Free Trade Agreement

The **North American Free Trade Agreement** (**NAFTA**) is an agreement signed by the governments of [Canada](http://en.wikipedia.org/wiki/Canada), [Mexico](http://en.wikipedia.org/wiki/Mexico), and the [United States](http://en.wikipedia.org/wiki/United_States), creating a trilateral [trade bloc](http://en.wikipedia.org/wiki/Trade_bloc) in North America. The agreement came into force on January 1, 1994. It superseded the [Canada – United States Free Trade Agreement](http://en.wikipedia.org/wiki/Canada_%E2%80%93_United_States_Free_Trade_Agreement) between the U.S. and Canada. In terms of combined [GDP](http://en.wikipedia.org/wiki/GDP) of its members, as of 2010 the trade bloc is the [largest in the world](http://en.wikipedia.org/wiki/Trade_bloc#Most_active_regional_blocs).

NAFTA has two supplements: the [North American Agreement on Environmental Cooperation](http://en.wikipedia.org/wiki/North_American_Agreement_on_Environmental_Cooperation) (NAAEC) and the North American Agreement on Labour Cooperation (NAALC).

## Central European Free Trade Agreement

The **Central European Free Trade Agreement** (**CEFTA**) is a [trade agreement](http://en.wikipedia.org/wiki/Trade_agreement) between non-[EU](http://en.wikipedia.org/wiki/European_Union) countries in [Southeast Europe](http://en.wikipedia.org/wiki/Southeast_Europe).

## NATO

The **North Atlantic Treaty Organization** or **NATO** (also called the **(North) Atlantic Alliance**, is an [intergovernmental](http://en.wikipedia.org/wiki/Intergovernmental_organization) [military alliance](http://en.wikipedia.org/wiki/Military_alliance) based on the [North Atlantic Treaty](http://en.wikipedia.org/wiki/North_Atlantic_Treaty) which was signed on 4 April 1949. The organization constitutes a system of [collective defence](http://en.wikipedia.org/wiki/Collective_defence) whereby its member states agree to mutual defense in response to an attack by any external party. NATO's headquarters are in [Brussels](http://en.wikipedia.org/wiki/Brussels), Belgium, one of the 28 member states across North America and Europe, the newest of which, Albania and Croatia, joined in April 2009. An additional 22 countries participate in NATO's [Partnership for Peace](http://en.wikipedia.org/wiki/Partnership_for_Peace), with 15 other countries involved in institutionalized dialogue programs. The combined military spending of all NATO members constitutes over 70% of [the world's defence spending](http://en.wikipedia.org/wiki/List_of_countries_by_military_expenditures).

Organization for Economic Co-operation and Development

The **Organisation for Economic Co-operation and Development** is an [international economic organisation](http://en.wikipedia.org/wiki/International_organization) of 34 countries founded in 1961 to stimulate economic progress and world trade. It is a forum of countries committed to [democracy](http://en.wikipedia.org/wiki/Democracy) and the [market economy](http://en.wikipedia.org/wiki/Market_economy), providing a platform to compare policy experiences, seek answers to common problems, identify good practices, and co-ordinate domestic and international policies of its members. The OECD's headquarters are at the [*Château de la Muette*](http://en.wikipedia.org/wiki/Ch%C3%A2teau_de_la_Muette) in [Paris](http://en.wikipedia.org/wiki/Paris), France.

## G8

The **Group of Eight** (**G8**) is a forum for the governments of eight large economies. (It excludes some members of the actual eight largest which are China, Brazil and India). The forum originated with a 1975 summit hosted by France that brought together representatives of six governments: [France](http://en.wikipedia.org/wiki/France), [Germany](http://en.wikipedia.org/wiki/Germany), [Italy](http://en.wikipedia.org/wiki/Italy), [Japan](http://en.wikipedia.org/wiki/Japan), the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom), and the [United States](http://en.wikipedia.org/wiki/United_States), thus leading to the name **Group of Six** or **G6**. The summit became known as the **Group of Seven** or **G7** the following year with the addition of [Canada](http://en.wikipedia.org/wiki/Canada). In 1997, [Russia](http://en.wikipedia.org/wiki/Russia) was added to group which then became known as the G8. The [European Union](http://en.wikipedia.org/wiki/European_Union) is represented within the G8 but cannot host or chair summits.

"G8" can refer to the member states in aggregate or to the annual [summit meeting](http://en.wikipedia.org/wiki/Summit_meeting) of the G8 [heads of government](http://en.wikipedia.org/wiki/Heads_of_government). The former term, G6, is now frequently applied to the [six most populous countries within the European Union](http://en.wikipedia.org/wiki/G6_(EU)). G8 ministers also meet throughout the year, such as the G7/8 finance ministers (who meet four times a year), G8 foreign ministers, or G8 environment ministers.

Collectively, the G8 nations comprise [51.0% of 2011 global nominal GDP](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)) and [42.5% of global GDP (PPP)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)). Each calendar year, the responsibility of hosting the G8 rotates through the member states in the following order: France, United States, United Kingdom, Russia, Germany, Japan, Italy, and Canada. The holder of the [presidency](http://en.wikipedia.org/wiki/Presidency) sets the agenda, hosts the summit for that year, and determines which ministerial meetings will take place. Lately, both France and the United Kingdom have expressed a desire to expand the group to include five developing countries, referred to as the **Outreach Five** (O5) or the Plus Five: [Brazil](http://en.wikipedia.org/wiki/Brazil), [People's Republic of China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China), [India](http://en.wikipedia.org/wiki/India), [Mexico](http://en.wikipedia.org/wiki/Mexico), and [South Africa](http://en.wikipedia.org/wiki/South_Africa). These countries have participated as guests in previous meetings, which are sometimes called [G8+5](http://en.wikipedia.org/wiki/G8%2B5).

With the [G-20 major economies](http://en.wikipedia.org/wiki/G-20_major_economies) growing in stature since the [2008 Washington summit](http://en.wikipedia.org/wiki/2008_G-20_Washington_summit), world leaders from the group announced at their [Pittsburgh summit](http://en.wikipedia.org/wiki/2009_G-20_Pittsburgh_summit) on September 25, 2009, that the group will replace the G8 as the main economic council of wealthy nations.

## History

[](http://en.wikipedia.org/wiki/File:34th_G8_summit_member_20080707.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:34th_G8_summit_member_20080707.jpg)

At the 34th G8 Summit at [Toyako, Hokkaido](http://en.wikipedia.org/wiki/Toyako,_Hokkaido), formal photo during Tanabata matsuri event for world leaders – Silvio Berlusconi (Italy), Dmitry Medvedev (Russia), Angela Merkel (Germany), Gordon Brown (UK), Yasuo Fukuda (Japan), George W. Bush (U.S.), Stephen Harper (Canada), Nicolas Sarkozy (France), José Barroso (EU) – July 7, 2008.

The concept of a forum for the world's major industrialized [democracies](http://en.wikipedia.org/wiki/Democracy) emerged following the [1973 oil crisis](http://en.wikipedia.org/wiki/1973_oil_crisis). In 1974, a series of meetings in the library of the [White House](http://en.wikipedia.org/wiki/White_House) in Washington, D.C. was known as the "Library Group".[[5]](http://en.wikipedia.org/wiki/G8#cite_note-4) This was an informal gathering of senior financial officials from the United States, the United Kingdom, [West Germany](http://en.wikipedia.org/wiki/West_Germany), Japan and France.[[6]](http://en.wikipedia.org/wiki/G8#cite_note-5) In 1975, French President [Valéry Giscard d'Estaing invited](http://en.wikipedia.org/wiki/Val%C3%A9ry_Giscard_d%27Estaing) the [heads of government](http://en.wikipedia.org/wiki/Heads_of_government) from West Germany, Italy, Japan, the United Kingdom and the United States to a summit in [Château de Rambouillet](http://en.wikipedia.org/wiki/Ch%C3%A2teau_de_Rambouillet). The six leaders agreed to an annual meeting organized under a rotating presidency, forming the Group of Six (G6). The following year, Canada joined the group at the behest of Germany's Chancellor [Helmut Schmidt](http://en.wikipedia.org/wiki/Helmut_Schmidt) and [U.S. President](http://en.wikipedia.org/wiki/President_of_the_United_States) [Gerald Ford](http://en.wikipedia.org/wiki/Gerald_Ford)[[7]](http://en.wikipedia.org/wiki/G8#cite_note-6) and the group became the Group of Seven ([G7](http://en.wikipedia.org/wiki/G7)). The [European Union](http://en.wikipedia.org/wiki/European_Union) is represented by the [President of the European Commission](http://en.wikipedia.org/wiki/President_of_the_European_Commission) and the leader of the country that holds the [Presidency of the Council of the European Union](http://en.wikipedia.org/wiki/Presidency_of_the_Council_of_the_European_Union). The [President of the European Commission](http://en.wikipedia.org/wiki/President_of_the_European_Commission) has attended all meetings since it was first invited by the United Kingdom in 1977[[8]](http://en.wikipedia.org/wiki/G8#cite_note-7) and the [Council President](http://en.wikipedia.org/wiki/President_of_the_European_Council) now also regularly attends.

Following [1994's G7 summit in Naples](http://en.wikipedia.org/wiki/20th_G7_summit), Russian officials held separate meetings with leaders of the G7 after the group's summits. This informal arrangement was dubbed the Political 8 (P8) – or, colloquially, the G7+1. At the invitation of [Prime Minister of the United Kingdom](http://en.wikipedia.org/wiki/Prime_Minister_of_the_United_Kingdom) [Tony Blair](http://en.wikipedia.org/wiki/Tony_Blair) and [President of the United States](http://en.wikipedia.org/wiki/President_of_the_United_States) [Bill Clinton](http://en.wikipedia.org/wiki/Bill_Clinton),[[9]](http://en.wikipedia.org/wiki/G8#cite_note-8) Russia formally joined the group in 1997, resulting in the Group of Eight, or G8.

### Food

A major focus of the G8 since 2009 has been the global supply of food.  At the 2009 L'Aquila summit, the G8's members promised to contribute $20 billion to the issue over three years. Since then, only 22% of the promised funds have been delivered.

At the 2012 summit, President Obama plans to ask G8 leaders to adopt a policy that would privatize global food investment.

## Structure and activities

[](http://en.wikipedia.org/wiki/File:33rdG8Leaders.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:33rdG8Leaders.jpg)

Leaders of the G8 on 7 June 2007, in [Heiligendamm](http://en.wikipedia.org/wiki/Heiligendamm), [Germany](http://en.wikipedia.org/wiki/Germany)

By design, the G8 deliberately lacks an administrative structure like those for international organizations, such as the [United Nations](http://en.wikipedia.org/wiki/United_Nations) or the [World Bank](http://en.wikipedia.org/wiki/World_Bank). The group does not have a permanent secretariat or offices for its members.

The presidency of the group rotates annually among the member countries, with each new term beginning on 1 January of the year. The country holding the presidency is responsible for planning and hosting a series of ministerial-level meetings, leading up to a mid-year summit attended by the heads of government. The president of the European Commission participates as an equal in all summit events.

The ministerial meetings bring together ministers responsible for various portfolios to discuss issues of mutual or global concern. The ranges of topics include health, law enforcement, labor, economic and social development, energy, environment, foreign affairs, justice and interior, terrorism, and trade. There are also a separate set of meetings known as the [G8+5](http://en.wikipedia.org/wiki/G8%2B5), created during the 2005 Gleneagles, Scotland summit, that is attended by finance and energy ministers from all eight member countries in addition to the five "outreach countries" which are also known as the [Group of Five](http://en.wikipedia.org/wiki/Group_of_Five) — [Brazil](http://en.wikipedia.org/wiki/Brazil), [People's Republic of China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China), [India](http://en.wikipedia.org/wiki/India), [Mexico](http://en.wikipedia.org/wiki/Mexico), and [South Africa](http://en.wikipedia.org/wiki/South_Africa).

In June 2005, justice ministers and interior ministers from the G8 countries agreed to launch an international database on [pedophiles](http://en.wikipedia.org/wiki/Pedophile). The G8 officials also agreed to pool data on [terrorism](http://en.wikipedia.org/wiki/Terrorism), subject to restrictions by privacy and security laws in individual countries.

### Global energy

[](http://en.wikipedia.org/wiki/File:G8_leaders_confer_together.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:G8_leaders_confer_together.jpg)

G8 leaders confer during the [2009 summit](http://en.wikipedia.org/wiki/35th_G8_summit) in [L'Aquila](http://en.wikipedia.org/wiki/L%27Aquila) ([Abruzzo](http://en.wikipedia.org/wiki/Abruzzo), [Italy](http://en.wikipedia.org/wiki/Italy)).

At the [Heiligendamm Summit](http://en.wikipedia.org/wiki/33rd_G8_summit) in 2007, the G8 acknowledged a proposal from the EU for a worldwide initiative on [efficient energy use](http://en.wikipedia.org/wiki/Efficient_energy_use). They agreed to explore, along with the [International Energy Agency](http://en.wikipedia.org/wiki/International_Energy_Agency), the most effective means to promote energy efficiency internationally. A year later, on 8 June 2008, the G8 along with China, [India](http://en.wikipedia.org/wiki/India), [South Korea](http://en.wikipedia.org/wiki/South_Korea) and the [European Community](http://en.wikipedia.org/wiki/European_Community) established the [International Partnership for Energy Efficiency Cooperation](http://en.wikipedia.org/wiki/International_Partnership_for_Energy_Efficiency_Cooperation), at the Energy Ministerial meeting hosted by Japan holding 2008 G8 Presidency, in [Aomori](http://en.wikipedia.org/wiki/Aomori,_Aomori).[

G8 Finance Ministers, whilst in preparation for the [34th Summit of the G8 Heads of State and Government](http://en.wikipedia.org/wiki/34th_G8_summit) in [Toyako, Hokkaido](http://en.wikipedia.org/wiki/Toyako,_Hokkaido), met on the 13 and 14 June 2008, in [Osaka, Japan](http://en.wikipedia.org/wiki/Osaka,_Japan). They agreed to the “G8 Action Plan for Climate Change to Enhance the Engagement of Private and Public Financial Institutions.” In closing, Ministers supported the launch of new [Climate Investment Funds](http://en.wikipedia.org/wiki/Climate_Investment_Funds) (CIFs) by the [World Bank](http://en.wikipedia.org/wiki/World_Bank), which will help existing efforts until a new framework under the [UNFCCC](http://en.wikipedia.org/wiki/UNFCCC) is implemented after 2012.

### Annual summit

The annual G8 leaders summit is attended by the heads of government. The member country holding the G8 presidency is responsible for organizing and hosting the year's summit.

## Member facts

G8-countries represent...

* 8 of 13 top-ranked leading export countries.
* 6 of 10 top-ranked countries with the largest [gold reserves](http://en.wikipedia.org/wiki/Gold_reserve) (USA, Germany, Italy, France, Russia and Japan.)
* 6 of 10 largest [major stock exchanges](http://en.wikipedia.org/wiki/List_of_stock_exchanges) by traded value and market capitalization
* 8 of 10 top-ranked economies (by [nominal GDP](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal))) of the world, according to latest (2011 data) International Monetary Fund's statistics.
* 5 of 20 top-ranked countries generating a [nominal GDP per capita](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)_per_capita) above US$40,000 (Canada, USA, Japan, France, Germany), from the same 2011 IMF data.
* 5 countries with a [sovereign wealth fund](http://en.wikipedia.org/wiki/Sovereign_wealth_fund), administered by either a national or a state/provincial government (Russia, USA, France, Canada, Italy).
* 8 of 30 top-ranked nations with large amounts of [foreign-exchange reserves](http://en.wikipedia.org/wiki/List_of_countries_by_foreign-exchange_reserves) in their [central banks](http://en.wikipedia.org/wiki/Central_bank)
* 4 out of 9 [countries having nuclear weapons](http://en.wikipedia.org/wiki/List_of_states_with_nuclear_weapons) (France, Russia, UK, USA),
* 3 additional countries that have the capability to rapidly produce nuclear warheads (Canada, Germany, Japan)
* 3 countries that have nuclear weapons sharing programs (Canada, Germany, Italy).
* 3 of the world's top-10 [largest oil producers](http://en.wikipedia.org/wiki/List_of_countries_by_oil_production) (Russia, USA and Canada)
* 2 countries with the third and eighth largest [oil reserves](http://en.wikipedia.org/wiki/Oil_reserves#Estimated_reserves_by_country) (Canada and Russia respectively) are in the G8
* 7 of the 9 largest [nuclear energy producers](http://en.wikipedia.org/wiki/Nuclear_power_by_country#Nuclear_power_output_in_megawatts) (USA, France, Japan, Russia, Germany, Canada, UK), even though Germany will wean itself from nuclear power by 2022. As with Japan, it shut down all of its nuclear reactors because of the [earthquake in 2011](http://en.wikipedia.org/wiki/2011_T%C5%8Dhoku_earthquake_and_tsunami); the first time the nation has gone nuclear-free since 1970.[[58]](http://en.wikipedia.org/wiki/G8#cite_note-57)
* the 7 largest donors to the [UN budget](http://en.wikipedia.org/wiki/United_Nations_funding) for the 2011 annual fiscal year (U.S., Japan, Germany, UK, France, Italy, Canada.)

All countries are among the ["trillion dollar club of nations"](http://en.wikipedia.org/wiki/Trillion_dollar_club). Until 1998 this "club" consisted only of G8-members. Today 14 out of 15 ["trillion dollar club" members](http://en.wikipedia.org/wiki/Trillion_dollar_club) are members of the [G20 members](http://en.wikipedia.org/wiki/G-20_major_economies).  
All of the G8 and 12 out of 13 [G8+5](http://en.wikipedia.org/wiki/G8%2B5)-countries (minus [South Africa](http://en.wikipedia.org/wiki/South_Africa)) are among the 20 top-ranked nations by the amount of voting power and [special drawing rights](http://en.wikipedia.org/wiki/Special_drawing_rights) (SDRs) in the [IMF organization](http://en.wikipedia.org/wiki/International_Monetary_Fund#Member_states).

## BRIC

In economics, **BRIC** is a grouping [acronym](http://en.wikipedia.org/wiki/Acronym) that refers to the [countries](http://en.wikipedia.org/wiki/Countries) of [Brazil](http://en.wikipedia.org/wiki/Brazil), [Russia](http://en.wikipedia.org/wiki/Russia), [India](http://en.wikipedia.org/wiki/India) and [China](http://en.wikipedia.org/wiki/People%27s_Republic_of_China), which are all deemed to be at a similar stage of newly advanced economic development. It is typically rendered as "the **BRICs**" or "the **BRIC** countries" or "the **BRIC** economies" or alternatively as the "Big Four".



The acronym was coined by [Jim O'Neill](http://en.wikipedia.org/wiki/Jim_O%27Neill_(economist)) in a 2001 paper entitled "Building Better Global Economic BRICs".[[1]](http://en.wikipedia.org/wiki/BRIC#cite_note-0)[[2]](http://en.wikipedia.org/wiki/BRIC#cite_note-1)[[3]](http://en.wikipedia.org/wiki/BRIC#cite_note-2) The acronym has come into widespread use as a symbol of the shift in global economic power away from the developed [G7](http://en.wikipedia.org/wiki/G7) economies towards the developing world. It is estimated that BRIC economies will overtake G7 economies by 2027.[[4]](http://en.wikipedia.org/wiki/BRIC#cite_note-3)

According to a paper published in 2005, [Mexico](http://en.wikipedia.org/wiki/Mexico) and [South Korea](http://en.wikipedia.org/wiki/South_Korea) were the only other countries comparable to the BRICs, but their economies were excluded initially because they were considered already more developed, as they were already members of the [OECD](http://en.wikipedia.org/wiki/OECD).[[5]](http://en.wikipedia.org/wiki/BRIC#cite_note-Ref-1-4) The same creator of the term "BRICS" has recently coined the term [MIKT](http://en.wikipedia.org/wiki/MIKT) that includes Mexico and (South) Korea.

Several of the more developed of the [N-11](http://en.wikipedia.org/wiki/Next_Eleven) countries, in particular [Turkey](http://en.wikipedia.org/wiki/Turkey), Mexico, [Indonesia](http://en.wikipedia.org/wiki/Indonesia) and [Nigeria](http://en.wikipedia.org/wiki/Nigeria), are seen as the most likely contenders to the BRICs. Some other developing countries that have not yet reached the N-11 economic level, such as [South Africa](http://en.wikipedia.org/wiki/South_Africa), aspire to BRIC status. Economists at the [Reuters](http://en.wikipedia.org/wiki/Reuters) 2011 Investment Outlook Summit, held on 6–7 December 2010, dismissed the notion of South Africa joining BRIC.[[6]](http://en.wikipedia.org/wiki/BRIC#cite_note-5) Jim O'Neill told the summit that he was constantly being lobbied about BRIC status by various countries. He said that South Africa, at a population of under 50 million people, was just too small an economy to join the BRIC ranks.[[7]](http://en.wikipedia.org/wiki/BRIC#cite_note-6) However, after the BRIC countries formed a political organization among themselves, they later expanded to include South Africa, becoming the [BRICS](http://en.wikipedia.org/wiki/BRICS).[[8]](http://en.wikipedia.org/wiki/BRIC#cite_note-7)

[Goldman Sachs](http://en.wikipedia.org/wiki/Goldman_Sachs) has argued that, since the four BRIC countries are developing rapidly, by 2050 their combined economies could eclipse the combined economies of the current richest countries of the world. These four countries, combined, currently account for more than a quarter of the world's land area and more than 40% of the [world's population](http://en.wikipedia.org/wiki/World_population).

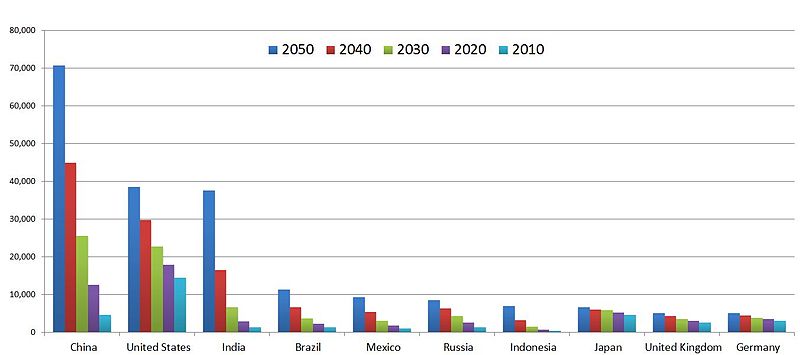
Goldman Sachs did not argue that the BRICs would organize themselves into an economic bloc, or a formal trading association, as the [European Union](http://en.wikipedia.org/wiki/European_Union) has done. However, there are some indications that the "four BRIC countries have been seeking to form a 'political club' or 'alliance'", and thereby converting "their growing economic power into greater geopolitical clout". On June 16, 2009, the leaders of the BRIC countries held their [first summit](http://en.wikipedia.org/wiki/2009_BRIC_summit) in [Yekaterinburg](http://en.wikipedia.org/wiki/Yekaterinburg), and issued a declaration calling for the establishment of an equitable, democratic and [multipolar](http://en.wikipedia.org/wiki/Polarity_in_international_relations) [world order](http://en.wikipedia.org/wiki/New_world_order_(politics)). Since then they have [met](http://en.wikipedia.org/wiki/2010_BRIC_summit) in [Brasília](http://en.wikipedia.org/wiki/Bras%C3%ADlia) in 2010, [met](http://en.wikipedia.org/wiki/2011_BRICS_summit) in [Sanya](http://en.wikipedia.org/wiki/Sanya) in 2011 and in New Delhi, India in 2012.

Thesis

Goldman Sachs argues that the economic potential of [Brazil](http://en.wikipedia.org/wiki/Economy_of_Brazil), [Russia](http://en.wikipedia.org/wiki/Economy_of_Russia), [India](http://en.wikipedia.org/wiki/Economy_of_India) and [China](http://en.wikipedia.org/wiki/Economy_of_the_People%27s_Republic_of_China) is such that they could become among the four most dominant economies by the year 2050. The thesis was proposed by [Jim O'Neill](http://en.wikipedia.org/wiki/Jim_O%27Neill_(economist)), global economist at Goldman Sachs. These countries encompass over 25% of the world's land coverage and 40% of the world's population and hold a combined [GDP](http://en.wikipedia.org/wiki/Gross_domestic_product) (PPP) of 18.486 trillion dollars. On almost every scale, they would be the largest entity on the global stage. These four countries are among the biggest and fastest growing [emerging markets](http://en.wikipedia.org/wiki/Emerging_market).

However, it is not the intent of Goldman Sachs to argue that these four countries are a political alliance (such as the [European Union](http://en.wikipedia.org/wiki/European_Union)) or any formal trading association, like [ASEAN](http://en.wikipedia.org/wiki/ASEAN). Nevertheless, they have taken steps to increase their political cooperation, mainly as a way of influencing the [United States](http://en.wikipedia.org/wiki/United_States) position on major trade accords, or, through the implicit threat of political cooperation, as a way of extracting political concessions from the United States, such as the proposed nuclear cooperation with India

|  | | | | |
| --- | --- | --- | --- | --- |
| **Categories** | **Brazil** | **Russia** | **India** | **China** |
| [**Area**](http://en.wikipedia.org/wiki/List_of_countries_and_outlying_territories_by_total_area) | 5th | **1st** | 7th | 3rd |
| [**Population**](http://en.wikipedia.org/wiki/List_of_countries_by_population) | 5th | 9th | 2nd | **1st** |
| [**Population growth rate**](http://en.wikipedia.org/wiki/List_of_countries_by_population_growth_rate) | 107th | 221st | **90th** | 156th |
| [**Labour force**](http://en.wikipedia.org/wiki/List_of_countries_by_labour_force) | 5th | 7th | 2nd | **1st** |
| [**GDP (nominal)**](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)) | 7th | 11th | 9th | **2nd** |
| [**GDP (PPP)**](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)) | 7th | 6th | 3rd | **2nd** |
| [**GDP (nominal) per capita**](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)_per_capita) | 55th | **54th** | 137th | 95th |
| [**GDP (PPP) per capita**](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)_per_capita) | 71st | **51st** | 127th | 93rd |
| [**GDP (real) growth rate**](http://en.wikipedia.org/wiki/List_of_countries_by_real_GDP_growth_rate) | 15th | 88th | 5th | **6th** |
| [**Human Development Index**](http://en.wikipedia.org/wiki/List_of_countries_by_Human_Development_Index) | 73rd | **65th** | 119th | 89th |
| [**Exports**](http://en.wikipedia.org/wiki/List_of_countries_by_exports) | 18th | 9th | 14th | **1st** |
| [**Imports**](http://en.wikipedia.org/wiki/List_of_countries_by_imports) | 19th | 17th | 11th | **2nd** |
| [**Current account balance**](http://en.wikipedia.org/wiki/List_of_countries_by_current_account_balance) | 47th | 5th | 169th | **1st** |
| [**Received FDI**](http://en.wikipedia.org/wiki/List_of_countries_by_received_FDI) | 11th | 12th | 29th | **5th** |
| [**Foreign exchange reserves**](http://en.wikipedia.org/wiki/List_of_countries_by_foreign_exchange_reserves) | 7th | 3rd | 6th | **1st** |
| [**External debt**](http://en.wikipedia.org/wiki/List_of_countries_by_external_debt) | **28th** | 24th | 26th | 23rd |
| [**Public debt**](http://en.wikipedia.org/wiki/List_of_countries_by_public_debt) | 47th | **122nd** | 29th | 98th |
| [**Electricity consumption**](http://en.wikipedia.org/wiki/List_of_countries_by_electricity_consumption) | 9th | 4th | 3rd | **2nd** |
| [**Renewable energy source**](http://en.wikipedia.org/wiki/List_of_countries_by_electricity_production_from_renewable_sources) | 3rd | 5th | 6th | **1st** |
| [**Number of mobile phones**](http://en.wikipedia.org/wiki/List_of_countries_by_number_of_mobile_phones_in_use) | 5th | 4th | 2nd | **1st** |
| [**Number of internet users**](http://en.wikipedia.org/wiki/List_of_countries_by_number_of_Internet_users) | 5th | 7th | 4th | **1st** |
| [**Motor vehicle production**](http://en.wikipedia.org/wiki/List_of_countries_by_motor_vehicle_production) | 7th | 19th | 6th | **1st** |
| [**Military expenditures**](http://en.wikipedia.org/wiki/List_of_countries_by_military_expenditures) | 12th | 5th | 10th | **2nd** |
| [**Active troops**](http://en.wikipedia.org/wiki/List_of_countries_by_number_of_troops) | 14th | 5th | 3rd | **1st** |
| [**Rail network**](http://en.wikipedia.org/wiki/List_of_countries_by_rail_transport_network_size) | 10th | **2nd** | 4th | 3rd |
| [**Road network**](http://en.wikipedia.org/wiki/List_of_countries_by_road_network_size) | 4th | 8th | 3rd | **2nd** |



History

Various sources refer to a purported "original" BRIC agreement that predates the Goldman Sachs thesis. Some of these sources claim that President [Vladimir Putin](http://en.wikipedia.org/wiki/Vladimir_Putin) of Russia was the driving force behind this original cooperative coalition of developing BRIC countries. However, thus far, no text has been made public of any formal agreement to which all four BRIC states are signatories. This does not mean, however, that they have not reached a multitude of bilateral or even quadrilateral agreements. Evidence of agreements of this type are abundant and are available on the foreign ministry websites of each of the four countries. Trilateral agreements and frameworks made among the BRICs include the [Shanghai Cooperation Organization](http://en.wikipedia.org/wiki/Shanghai_Cooperation_Organization) (member states include Russia and China, observers include India) and the [IBSA Trilateral Forum](http://en.wikipedia.org/wiki/IBSA_Dialogue_Forum), which unites Brazil, India, and [South Africa](http://en.wikipedia.org/wiki/South_Africa) in annual dialogues. Also important to note is the [G-20](http://en.wikipedia.org/wiki/G-20) coalition of developing states which includes all the BRICs.

Also, because of the popularity of the Goldman Sachs thesis "BRIC", this term has sometimes been extended whereby "BRICK" (K for South Korea), "[BRIMC](http://en.wikipedia.org/wiki/BRIMC)" (M for Mexico), "BRICA" ([GCC](http://en.wikipedia.org/wiki/Gulf_Cooperation_Council)Arab countries – [Saudi Arabia](http://en.wikipedia.org/wiki/Saudi_Arabia), [Qatar](http://en.wikipedia.org/wiki/Qatar), [Kuwait](http://en.wikipedia.org/wiki/Kuwait), [Bahrain](http://en.wikipedia.org/wiki/Bahrain), [Oman](http://en.wikipedia.org/wiki/Oman) and the [United Arab Emirates](http://en.wikipedia.org/wiki/United_Arab_Emirates)) and "BRICET" (including Eastern Europe and [Turkey](http://en.wikipedia.org/wiki/Turkey)) have become more generic [marketing](http://en.wikipedia.org/wiki/Marketing) terms to refer to these emerging markets.

In an August 2010 [op-ed](http://en.wikipedia.org/wiki/Op-ed), Jim O'Neill of Goldman Sachs argued that Africa could be considered the next BRIC. Analysts from rival banks have sought to move beyond the BRIC concept, by introducing their own groupings of emerging markets. Proposals include CIVETs (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa), the EAGLES (Emerging and Growth-Leading Economies) and the 7 per cent Club (which includes those countries which have averaged economic growth of at least 7 per cent a year).

South Africa sought BRIC membership since 2009 and the process for formal admission began as early as August 2010.  South Africa was officially admitted as a BRIC nation on December 24, 2010 after being invited by China and the other BRIC countries to join the group. The capital “S” in BRICS stands for South Africa. President [Jacob Zuma](http://en.wikipedia.org/wiki/Jacob_Zuma) attends the BRICS summit in [Sanya](http://en.wikipedia.org/wiki/Sanya) in April 2011 as a full member. South Africa stands at a unique position to influence African economic growth and investment. According to [Jim O’Neill](http://en.wikipedia.org/wiki/Jim_O%27Neill_(economist)) of Goldman Sachs who originally coined the term, Africa's combined current gross domestic product is reasonably similar to that of Brazil and Russia, and slightly above that of India. South Africa is a "gateway" to Southern Africa and Africa in general as the most developed African country. China is South Africa’s largest trading partner, and India wants to increase commercial ties to Africa. South Africa is also Africa’s largest economy, but as number 31 in global GDP economies it is far behind its new partners.

[Jim O'Neill](http://en.wikipedia.org/wiki/Jim_O%27Neill_(economist)) expressed surprise when South Africa joined BRIC since South Africa's economy is a quarter of the size of Russia's (the least economically powerful BRIC nation). He believed that the potential was there but did not anticipate inclusion of South Africa at this stage. Martyn Davies, a South African emerging markets expert, argued that the decision to invite South Africa made little commercial sense but was politically astute given China's attempts to establish a foothold in Africa. Further, South Africa's inclusion in BRICS may translate to greater South African support for China in global fora.

African credentials are important geopolitically, giving BRICS a four-continent breadth, influence and trade opportunities. South Africa's addition is a deft political move that further enhances BRICS’ power and status. In the original essay that coined the term, Goldman Sachs did not argue that the BRICs would organize themselves into an economic bloc, or a formal trading association which this move signifies.

### Marketing

[](http://en.wikipedia.org/wiki/File:Sao_Paulo_Stock_Exchange.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Sao_Paulo_Stock_Exchange.jpg)

The [São Paulo Stock Exchange](http://en.wikipedia.org/wiki/BM%26F_Bovespa) is the third-largest exchange operator by market value in the world.[[39]](http://en.wikipedia.org/wiki/BRIC#cite_note-38)

The BRIC term is also used by companies who refer to the four named countries as key to their [emerging markets](http://en.wikipedia.org/wiki/Emerging_market) strategies. By comparison the reduced acronym IC would not be attractive, although the term "[Chindia](http://en.wikipedia.org/wiki/Chindia)" is often used. The BRIC's study specifically focuses on large countries, not necessarily the wealthiest or the most productive and was never intended to be an investment thesis. If investors read the Goldman's research carefully, and agreed with the conclusions, then they would gain exposure to Asian debt and equity markets rather than to [Latin America](http://en.wikipedia.org/wiki/Latin_America). According to estimates provided by the USDA, the wealthiest regions outside of the G6 in 2015 will be [Hong Kong](http://en.wikipedia.org/wiki/Hong_Kong), South Korea and [Singapore](http://en.wikipedia.org/wiki/Singapore). Combined with China and India, these five economies are likely to be the world's five most influential economies outside of the G6.

On the other hand, when the "R" in BRIC is extended beyond Russia and is used as a loose term to include all of Eastern Europe as well, then the BRIC story becomes more compelling. At issue are the multiple serious problems which confront Russia (potentially unstable government, environmental degradation, critical lack of modern infrastructure, etc. and the comparatively much lower growth rate seen in Brazil. However, Brazil's lower growth rate obscures the fact that the country is wealthier than China or India on a per-capita basis, has a more developed and global integrated financial system and has an economy potentially more diverse than the other BRICs due to its raw material and manufacturing potential. Many other Eastern European countries, such as [Poland](http://en.wikipedia.org/wiki/Poland), [Romania](http://en.wikipedia.org/wiki/Romania), the [Czech Republic](http://en.wikipedia.org/wiki/Czech_Republic), [Slovakia](http://en.wikipedia.org/wiki/Slovakia), [Hungary](http://en.wikipedia.org/wiki/Hungary), [Bulgaria](http://en.wikipedia.org/wiki/Bulgaria), and several others were able to continually sustain high economic growth rates and do not experience some of the problems that Russia experiences or experience them to a lesser extent. In terms of [GDP per capita](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)_per_capita) in 2008, Brazil ranked 64th, Russia 42nd, India 113th and China 89th. By comparison South Korea ranked 24th and Singapore 3rd.

Brazil's stock market, the [Bovespa](http://en.wikipedia.org/wiki/Bovespa), has gone from approximately 9,000 in September 2002 to over 70,000 in May 2008. Government policies have favored investment (lowering interest rates), retiring foreign debt and expanding growth, and a reformulation of the tax system is being voted in the congress. The British author and researcher [Mark Kobayashi-Hillary](http://en.wikipedia.org/wiki/Mark_Kobayashi-Hillary) wrote a book in 2007 titled 'Building a Future with BRICs' for European publisher [Springer Verlag](http://en.wikipedia.org/wiki/Springer_Science%2BBusiness_Media) that examines the growth of the BRICs region and its effect on global sourcing. Contributors to the book include [Nandan Nilekani](http://en.wikipedia.org/wiki/Nandan_Nilekani), and [Shiv Nadar](http://en.wikipedia.org/wiki/Shiv_Nadar).

### International Law

Brazilian lawyer and author Adler Martins has published a paper called "Contratos Internacionais entre os países do BRIC" (International Agreements Among BRIC countries) which highlights the international conventions ratified by the BRIC countries, which allow them to maintain trade and investment activities safely within the group. Mr. Martin's study is being further developed by the Federal University of the Minas Gerais State, in Brazil.

### Financial diversification

It has been argued that geographic [diversification](http://en.wikipedia.org/wiki/Diversification_(finance)) would eventually generate superior risk-adjusted returns for [long-term](http://en.wikipedia.org/wiki/Long-term) global investors by reducing overall portfolio risk while capturing some of the higher rates of return offered by the markets of [Asia](http://en.wikipedia.org/wiki/Asia), [Eastern Europe](http://en.wikipedia.org/wiki/Eastern_Europe) and [Latin America](http://en.wikipedia.org/wiki/Latin_America). By doing so, these [institutional investors](http://en.wikipedia.org/wiki/Institutional_investor) have contributed to the financial and economic development of key emerging nations such as Brazil, India, China, and Russia. For global investors, India and China constitute both large-scale production platforms and reservoirs of new consumers, whereas Russia is viewed essentially as an exporter of oil and commodities- Brazil and Latin America being somehow "in the middle".

### Criticism

A criticism is that the BRIC projections are based on the assumptions that resources are limitless and endlessly available when needed. In reality, many important resources currently necessary to sustain economic growth, such as [oil, natural gas, coal, other fossil fuels, and uranium](http://en.wikipedia.org/wiki/Peak_oil) might soon experience a peak in production before enough renewable energy can be developed and commercialized, which might result in slower economic growth than anticipated, thus throwing off the projections and their dates. The economic emergence of the BRICs will have unpredictable consequences for the global environment. Indeed, proponents of a set [carrying capacity](http://en.wikipedia.org/wiki/Carrying_capacity) for the Earth may argue that, given current technology, there is a finite limit to how much the BRICs can develop before exceeding the ability of the global economy to supply.

Academics and experts have suggested that China is in a league of its own compared to the other BRIC countries. As [David Rothkopf](http://en.wikipedia.org/wiki/David_Rothkopf) wrote in [*Foreign Policy*](http://en.wikipedia.org/wiki/Foreign_Policy), "Without China, the BRICs are just the BRI, a bland, soft cheese that is primarily known for the whine [sic] that goes with it. China is the muscle of the group and the Chinese know it. They have effective [veto power](http://en.wikipedia.org/wiki/Veto_power) over any BRIC initiatives because without them, who cares really? They are the one with the big [reserves](http://en.wikipedia.org/wiki/Foreign_exchange_reserves). They are the biggest potential [market](http://en.wikipedia.org/wiki/Market). They are the [U.S.](http://en.wikipedia.org/wiki/U.S.) partner in the [G2](http://en.wikipedia.org/wiki/Group_of_Two) (imagine the coverage a G2 meeting gets vs. a [G8](http://en.wikipedia.org/wiki/G8) meeting) and the E2 (no climate deal without them) and so on." [Deutsche Bank](http://en.wikipedia.org/wiki/Deutsche_Bank) Research said in a report that "economically, financially and politically, China overshadows and will continue to overshadow the other BRICs." It added that China's economy is larger than that of the three other BRIC economies (Brazil, Russia and India) combined. Moreover, China's [exports](http://en.wikipedia.org/wiki/Exports) and its official [foreign-exchange reserves](http://en.wikipedia.org/wiki/Foreign-exchange_reserves) are more than twice as large as those of the other BRICs combined. In that perspective, some pension investment experts have argued that “China alone accounts for more than 70% of the combined GDP growth generated by the BRIC countries [from 1999 to 2010]: if there is a BRIC miracle it’s first and foremost a Chinese one”. The "growth gap" between China and other large emerging economies such as Brazil, Russia and India can be attributed to a large extent to China's early focus on ambitious infrastructure projects: while China invested roughly 9% of its GDP on infrastructure in the 1990s and 2000s, most emerging economies invested only 2% to 5% of their GDP. This considerable spending gap allowed the Chinese economy to grow at near optimal conditions while many South American and South Asian economies suffered from various development bottlenecks (poor transportation networks, aging power grids, mediocre schools...).

The preeminence of China and India as major manufacturing countries with unrealised potential has been widely recognised, but some commentators state that China's and Russia's large-scale disregard for human rights and democracy could be a problem in the future. Human rights issues do not inform the foreign policies of these two countries to the same extent as they do the policies of other large states such as Japan, India, the EU states and the USA. There is also the possibility of conflict over [Taiwan](http://en.wikipedia.org/wiki/Taiwan) in the case of China.

There is also the issue of population growth. The population of Russia has been declining rapidly in the 1990s and only recently did the Russian government predict the population to stabilize and grow in 2020. Brazil's and China's populations will begin to decline in several decadeswith their demographic windows closing in several decades as well. This may have implications for those countries' future, for there might be a decrease in the overall labor force and a negative change in the proportion of workers to retirees.

Brazil's economic potential has been anticipated for decades, but it had until recently consistently failed to achieve investor expectations. Only in recent years has the country established a framework of political, economic, and social policies that allowed it to resume consistent growth. The result has been solid and paced economic development that rival its early 70's "miracle years", as reflected in its expanding capital markets, lowest unemployment rates in decades, and consistent international trade surpluses - that led to the accumulation of reserves and liquidation of foreign debt (earning the country a coveted investment grade by the S&P and Fitch Ratings in 2008).

Finally, India's relations with its neighbor Pakistan have always been tense. In 1998, there was a nuclear standoff between Pakistan and India. Border conflicts with Pakistan, mostly over the long held dispute over Kashmir, has further aggravated any economic ties. This impedes progress by limiting government finances, increasing social unrest, and limiting potential domestic economic demand. Factors such as international conflict, civil unrest, unwise political policy, outbreaks of disease and terrorism are all factors that are difficult to predict and that could have an effect on the destiny of any country.

Other critics suggest that BRIC is nothing more than a neat acronym for the four largest emerging market economies, but in economic and political terms nothing else (apart from the fact that they are all big emerging markets) links the four. Two are manufacturing based economies and big importers (China and India), but two are huge exporters of natural resources (Brazil and Russia). [*The Economist*](http://en.wikipedia.org/wiki/The_Economist), in its special report on Brazil, expressed the following view: "In some ways Brazil is the steadiest of the BRICs. Unlike China and Russia it is a full-blooded democracy; unlike India it has no serious disputes with its neighbors. It is the only BRIC without a nuclear bomb." The [Heritage Foundation](http://en.wikipedia.org/wiki/Heritage_Foundation)'s "[Economic Freedom Index](http://en.wikipedia.org/wiki/Indices_of_Economic_Freedom)", which measures factors such as protection of property rights and free trade ranks Brazil ("moderately free") above the other BRICs ("mostly unfree"). [Henry Kissinger](http://en.wikipedia.org/wiki/Henry_Kissinger) has stated that the BRIC nations have no hope of acting together as a coherent bloc in world affairs, and that any cooperation will be the result of forces acting on the individual nations.[

It is also noticed that BRIC countries have undermined qualitative factors that is reflected in deterioration in Doing Business ranking 2010 and other several human indexes.

In a not-so-subtle dig critical of the term as nothing more than shorthand for emerging markets generally, critics have suggested a correlating term, CEMENT (*C*ountries in *E*merging *M*arkets *E*xcluded by *N*ew *T*erminology). Whilst they accept there has been spectacular growth of the BRIC economies, these gains have largely been the result of the strength of emerging markets generally, and that strength comes through having BRICs and CEMENT.

Proposed inclusions

Mexico and South Korea are currently the world's 13th and 15th largest by [nominal GDP](http://en.wikipedia.org/wiki/Nominal_GDP) just behind the BRIC and G7 economies. Both are experiencing rapid GDP growth of 5% every year, a figure comparable to Brazil from the original BRICs. [Jim O'Neill](http://en.wikipedia.org/wiki/Jim_O%27Neill_(economist)), expert from the same bank and creator of the economic thesis, stated that in 2001 when the paper was created, it did not consider Mexico, but today it has been included because the country is experiencing the same factors that the other countries first included present. While South Korea was not originally included in the BRICs, recent solid economic growth led to Goldman Sachs proposing to add Mexico and South Korea to the BRICs, changing the acronym to BRIMCK, with Jim O'Neill pointing out that Korea "is better placed than most others to realize its potential due to its growth-supportive fundamentals. Again Jim O'Neil recently created the term [MIKT](http://en.wikipedia.org/wiki/MIKT) that stands for Mexico, Indonesia, Korea (South Korea), and Turkey.

A Goldman Sachs paper published later in December 2005 explained why Mexico and South Korea weren't included in the original BRICs. According to the paper, among the other countries they looked at, only Mexico and South Korea have the potential to rival the BRICs, but they are economies that they decided to exclude initially because they looked to them as already more developed. However, due to the popularity of the Goldman Sachs thesis, "BRIMC" and "BRICK" are becoming more generic marketing terms to refer to these six countries.

The term is primarily used in the economic and financial spheres as well as in [academia](http://en.wikipedia.org/wiki/Academia). Its usage has grown especially in the investment sector, where it is used to refer to the bonds emitted by these emerging markets governments.

### Mexico

[](http://en.wikipedia.org/wiki/File:Atardecer_reforma.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Atardecer_reforma.jpg)

Primarily, along with the BRICs, Goldman Sachs argues that the economic potential of Brazil, Russia, India, Mexico and [China](http://en.wikipedia.org/wiki/China) is such that they may become (with the USA) the six most dominant economies by the year 2050. Due to Mexico's rapidly advancing infrastructure, increasing middle class and rapidly declining poverty rates it is expected to have a higher GDP per capita than all but three European countries by 2050, this new found local wealth also contributes to the nation's economy by creating a large domestic consumer market which in turn creates more jobs.

|  |  |
| --- | --- |
| **Mexico in 2050** | |
| [GDP](http://en.wikipedia.org/wiki/GDP) in [USD](http://en.wikipedia.org/wiki/USD) | $9.340 trillion |
| [GDP per capita](http://en.wikipedia.org/wiki/GDP_per_capita) | $63,149 |
| [GDP growth](http://en.wikipedia.org/wiki/GDP_growth) (2015–2050) | 4.0% |
| [Total population](http://en.wikipedia.org/wiki/Population) | 142 million |

**South Korea**

[](http://en.wikipedia.org/wiki/File:Gangnam_Station_and_Samsung_Town,_New_Downtown_Seoul_in_Korea.jpg)

[Seoul](http://en.wikipedia.org/wiki/Seoul), South Korea

South Korea is by far the most highly [developed country](http://en.wikipedia.org/wiki/Developed_country) when compared to the BRICs and N-11s. It has achieved an incomparable level of development compared to these groups, with its [Human Development Index](http://en.wikipedia.org/wiki/Human_Development_Index) higher than some of the world's most advanced economies, including [France](http://en.wikipedia.org/wiki/France), [UK](http://en.wikipedia.org/wiki/UK), [Austria](http://en.wikipedia.org/wiki/Austria), [Denmark](http://en.wikipedia.org/wiki/Denmark), [Finland](http://en.wikipedia.org/wiki/Finland) and [Belgium](http://en.wikipedia.org/wiki/Belgium). When compared to other [OECD](http://en.wikipedia.org/wiki/OECD) members in 2010, South Korean workers had a higher disposable income than [Germany](http://en.wikipedia.org/wiki/Germany), [Japan](http://en.wikipedia.org/wiki/Japan) and [Sweden](http://en.wikipedia.org/wiki/Sweden), by far the highest in Asia with the strongest growth rate that is more than quadruple that of the [United States](http://en.wikipedia.org/wiki/United_States) in the same period. Despite these conditions, it has been achieving growth rates of 4-6%, a figure more than double to triple that of other advanced economies. More importantly, it has a significantly higher Growth Environment Score (Goldman Sachs' way of measuring the long-term sustainability of growth) than all of the BRICs or N-11s.[[54]](http://en.wikipedia.org/wiki/BRIC#cite_note-www2.goldmansachs.com-53) Commentators such as William Pesek Jr. from [Bloomberg](http://en.wikipedia.org/wiki/Bloomberg_L.P.) argue that Korea is "Another 'BRIC' in Global Wall", suggesting that it stands out from the [Next Eleven](http://en.wikipedia.org/wiki/Next_Eleven) economies. By [GDP (PPP)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)), South Korea already overtook a [G7](http://en.wikipedia.org/wiki/G7) and [G8](http://en.wikipedia.org/wiki/G8) economy, [Canada](http://en.wikipedia.org/wiki/Canada), in 2009, surpassing [Spain](http://en.wikipedia.org/wiki/Spain) in 2010. According to the [IMF](http://en.wikipedia.org/wiki/IMF) World Economic Outlook, it will overtake [Italy](http://en.wikipedia.org/wiki/Italy) in 2014 and [Mexico](http://en.wikipedia.org/wiki/Mexico) in 2016 to become one of the world's top ten economies and the 6th largest among developed countries. In terms of [GDP per capita (PPP)](http://en.wikipedia.org/wiki/List_of_countries_by_past_and_future_GDP_(PPP)_per_capita), South Korea has surpassed many developed countries, including [Portugal](http://en.wikipedia.org/wiki/Portugal) in 2003, [New Zealand](http://en.wikipedia.org/wiki/New_Zealand) in 2008 and [Greece](http://en.wikipedia.org/wiki/Greece), [Spain](http://en.wikipedia.org/wiki/Spain) and [Italy](http://en.wikipedia.org/wiki/Italy) in 2010. At current speeds, it will surpass [Japan](http://en.wikipedia.org/wiki/Japan) and [France](http://en.wikipedia.org/wiki/France) in 2016. While measuring the [South Korean economy](http://en.wikipedia.org/wiki/South_Korean_economy) by [nominal GDP](http://en.wikipedia.org/wiki/Nominal_GDP) is inaccurate as the [South Korean won](http://en.wikipedia.org/wiki/South_Korean_won) is artificially kept low to boost [exports](http://en.wikipedia.org/wiki/Exports), economists from other investment firms argue that even when measured by [nominal GDP per capita](http://en.wikipedia.org/wiki/Nominal_GDP), South Korea will achieve over $96,000 by 2050, surpassing the [United States](http://en.wikipedia.org/wiki/United_States) and by far the wealthiest among the world's major economies, suggesting that wealth is more important than size for bond investors, stating that Korea's credit rating will be rated AAA sooner than 2050.

**United Korea**

[](http://en.wikipedia.org/wiki/File:Pyongyang_western_view_April_2010.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Pyongyang_western_view_April_2010.jpg)

[Pyongyang](http://en.wikipedia.org/wiki/Pyongyang), North Korea

In September 2009, Goldman Sachs published its 188th Global Economics Paper named "A United Korea?" which highlighted in detail the potential economic power of a United Korea, which will surpass all current G7 countries except the [United States](http://en.wikipedia.org/wiki/United_States), such as [Japan](http://en.wikipedia.org/wiki/Japan), the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom), [Germany](http://en.wikipedia.org/wiki/Germany) and [France](http://en.wikipedia.org/wiki/France) within 30–40 years of reunification, estimating GDP to surpass $6 trillion by 2050. The young, skilled labor and large amount of natural resources from the North combined with advanced technology, infrastructure and large amount of capital in the South, as well as Korea's strategic location connecting three economic powers, is likely going to create an economy larger than the bulk of the G7. According to some opinions, a [reunited Korea](http://en.wikipedia.org/wiki/Korean_reunification) could occur before 2050, or even between 2010 and 2020.[  If it occurred, Korean reunification would immediately raise the country's population to over 70 million.[

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| **Korea in 2050** | | | |
|  | **[Korea](http://en.wikipedia.org/wiki/Korea)**[**United Korea**](http://en.wikipedia.org/wiki/Korean_reunification) | **http://upload.wikimedia.org/wikipedia/commons/thumb/0/09/Flag_of_South_Korea.svg/22px-Flag_of_South_Korea.svg.png**[**South Korea**](http://en.wikipedia.org/wiki/South_Korea) | **http://upload.wikimedia.org/wikipedia/commons/thumb/5/51/Flag_of_North_Korea.svg/22px-Flag_of_North_Korea.svg.png**[**North Korea**](http://en.wikipedia.org/wiki/North_Korea) |
| [GDP](http://en.wikipedia.org/wiki/GDP) in [USD](http://en.wikipedia.org/wiki/USD) | $6.056 trillion | $4.073 trillion | $1.982 trillion |
| [GDP per capita](http://en.wikipedia.org/wiki/GDP_per_capita) | $86,000 | $96,000 | $70,000 |
| [GDP growth](http://en.wikipedia.org/wiki/GDP_growth) (2015–2050) | 4.8% | 3.9% | 11.4% |
| [Total population](http://en.wikipedia.org/wiki/Population) | 71 million | 42 million | 28 million |

# VIII Marketing

Marketing is "*the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large."*

For business to consumer marketing it is *"the process by which companies create value for customers and build strong customer relationships, in order to capture value from customers in return".* For business to business marketing it is creating value, solutions, and relationships either short term or long term with a company or brand. It generates the strategy that underlies sales techniques, business communication, and business developments. It is an integrated process through which companies build strong [customer relationships](http://en.wikipedia.org/wiki/Customer_relationship_management) and create value for their customers and for themselves.

Marketing is used to identify the [customer](http://en.wikipedia.org/wiki/Customer), satisfy the customer, and keep the customer. With the customer as the focus of its activities, [marketing management](http://en.wikipedia.org/wiki/Marketing_management) is one of the major components of [business management](http://en.wikipedia.org/wiki/Outline_of_business_management). Marketing evolved to meet the stasis in developing new markets caused by [mature markets](http://en.wikipedia.org/wiki/Mature_market) and [overcapacities](http://en.wikipedia.org/wiki/Overcapacity) in the last 2-3 centuries. The adoption of marketing strategies requires businesses to shift their focus from [production](http://en.wikipedia.org/wiki/Manufacturing) to the perceived needs and wants of their customers as the means of staying [profitable](http://en.wikipedia.org/wiki/Profit_(accounting)).

The term marketing concept holds that achieving organizational goals depends on knowing the needs and wants of [target markets](http://en.wikipedia.org/wiki/Target_markets) and delivering the desired satisfactions. It proposes that in order to satisfy its organizational objectives, an organization should anticipate the needs and wants of consumers and satisfy these more effectively than competitors.

The term developed from an original meaning which referred literally to going to a market to buy or sell goods or services. Seen from a systems point of view, [sales process engineering](http://en.wikipedia.org/wiki/Sales_process_engineering) marketing is "*a set of processes that are interconnected and interdependent with other functions, whose methods can be improved using a variety of relatively new approaches."*

The [Chartered Institute of Marketing](http://en.wikipedia.org/wiki/Chartered_Institute_of_Marketing) defines marketing as *"the management process responsible for identifying, anticipating and satisfying customer requirements profitably."*A different concept is the [*value-based marketing*](http://en.wikipedia.org/wiki/Value-based_marketing) which states the role of marketing to contribute to increasing [shareholder value](http://en.wikipedia.org/wiki/Shareholder_value). In this context, marketing is defined as *"the management process that seeks to maximize returns to shareholders by developing relationships with valued customers and creating a competitive advantage."*

Marketing practice tended to be seen as a creative industry in the past, which included [advertising](http://en.wikipedia.org/wiki/Advertising), [distribution](http://en.wikipedia.org/wiki/Distribution_(business)) and [selling](http://en.wikipedia.org/wiki/Sales), Merchandise support. However, because the academic study of marketing makes extensive use of [social sciences](http://en.wikipedia.org/wiki/Social_sciences),[psychology](http://en.wikipedia.org/wiki/Psychology), [sociology](http://en.wikipedia.org/wiki/Sociology), [mathematics](http://en.wikipedia.org/wiki/Mathematics), [economics](http://en.wikipedia.org/wiki/Economics), [anthropology](http://en.wikipedia.org/wiki/Anthropology) and [neuroscience](http://en.wikipedia.org/wiki/Neuroscience), the profession is now widely recognized as a science, allowing numerous universities to offer Master-of-Science (MSc) programmes. The overall process starts with marketing research and goes through [market segmentation](http://en.wikipedia.org/wiki/Market_segmentation), business planning and execution, ending with pre- and post-sales promotional activities. It is also related to many of the [creative](http://en.wikipedia.org/wiki/Creativity) arts. The marketing literature is also adept at re-inventing itself and its vocabulary according to the times and the culture.

## International marketing

**International marketing (IM)** or **global marketing** refers to [marketing](http://en.wikipedia.org/wiki/Marketing) carried out by companies overseas or across national borderlines. This strategy uses an extension of the techniques used in the home country of a firm. It refers to the firm-level marketing practices across the border including market identification and targeting, entry mode selection, marketing mix, and strategic decisions to compete in international markets. According to the [American Marketing Association (AMA)](http://en.wikipedia.org/wiki/American_Marketing_Association)"***international marketing****is the multinational process of planning and executing the conception, pricing, promotion and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives.*" In contrast to the definition of marketing only the word *multinational* has been added. In simple words international marketing is the application of marketing principles to across national boundaries. However, there is a crossover between what is commonly expressed as international marketing and global marketing, which is a similar term.

The intersection is the result of the process of [internationalization](http://en.wikipedia.org/wiki/Internationalization). Many American and European authors see international marketing as a simple extension of exporting, whereby the [marketing mix](http://en.wikipedia.org/wiki/Marketing_mix) [4P's](http://en.wikipedia.org/wiki/4P%27s) is simply adapted in some way to take into account differences in consumers and segments. It then follows that global marketing takes a more standardized approach to world markets and focuses upon sameness, in other words the similarities in consumers and segments.

## Marketing research

Marketing research involves conducting research to support marketing activities, and the statistical interpretation of data into information. This information is then used by managers to plan marketing activities, gauge the nature of a firm's marketing environment and attain information from suppliers. Marketing researchers use statistical methods such as [quantitative research](http://en.wikipedia.org/wiki/Quantitative_research), [qualitative research](http://en.wikipedia.org/wiki/Qualitative_research), [hypothesis tests](http://en.wikipedia.org/wiki/Statistical_hypothesis_testing), [Chi-squared tests](http://en.wikipedia.org/wiki/Chi-squared_test), [linear regression](http://en.wikipedia.org/wiki/Linear_regression), [correlations](http://en.wikipedia.org/wiki/Correlation_and_dependence), [frequency distributions](http://en.wikipedia.org/wiki/Frequency_distribution), [poisson distributions](http://en.wikipedia.org/wiki/Poisson_distribution), [binomial distributions](http://en.wikipedia.org/wiki/Binomial_distribution), etc. to interpret their findings and convert data into information. The marketing research process spans a number of stages, including the definition of a problem, development of a research plan, collection and interpretation of data and disseminating information formally in the form of a report. The task of marketing research is to provide management with relevant, accurate, reliable, valid, and current information.

A distinction should be made between [**marketing research**](http://en.wikipedia.org/wiki/Marketing_research) and [**market research**](http://en.wikipedia.org/wiki/Market_research). Market research pertains to research in a given market. As an example, a firm may conduct research in a target market, after selecting a suitable market segment. In contrast, marketing research relates to all research conducted within marketing. Thus, market research is a subset of marketing research.

Marketing research is the systematic gathering, recording, and analysis of data about issues relating to [marketing](http://en.wikipedia.org/wiki/Marketing) products and services. The goal of marketing research is to identify and assess how changing elements of the [marketing mix](http://en.wikipedia.org/wiki/Marketing_mix) impacts [customer behaviour](http://en.wikipedia.org/wiki/Customer_behavior). The term is commonly interchanged with [market research](http://en.wikipedia.org/wiki/Market_research); however, expert practitioners may wish to draw a distinction, in that market research is concerned specifically with [markets](http://en.wikipedia.org/wiki/Markets), while marketing research is concerned specifically about marketing processes. It has been described as "the function that links the consumers, customers, and public to the marketer through information — information used to identify and define marketing opportunities and problems; generate, refine, and evaluate marketing actions; monitor marketing performance; and improve understanding of marketing as a process. Marketing research specifies the information required to address these issues, designs the method for collecting information, manages and implements the data collection process, analyzes the results, and communicates the findings and their implications."

Marketing research is often partitioned into two sets of categorical pairs, either by target market:

* Consumer marketing research, and
* Business-to-business (B2B) marketing research

Or, alternatively, by methodological approach:

* Qualitative marketing research, and
* Quantitative marketing research

Consumer marketing research is a form of applied [sociology](http://en.wikipedia.org/wiki/Sociology) that concentrates on understanding the preferences, attitudes, and behaviours of [consumers](http://en.wikipedia.org/wiki/Consumer) in a market-based economy, and it aims to understand the effects and comparative success of marketing campaigns.

Thus, marketing research may also be described as the systematic and objective identification, collection, analysis, and dissemination of information for the purpose of assisting management in decision making related to the identification and solution of problems and opportunities in [marketing](http://en.wikipedia.org/wiki/Marketing).

### Types of Market Research

Market research, as a sub-set aspect of marketing activities, can be divided into the following parts:

* Primary research (also known as field research), which involves the conduction and compilation of research for a specific purpose.
* Secondary research (also referred to as desk research), initially conducted for one purpose, but often used to support another purpose or end goal.

**Strategic planning** is an [organization](http://en.wikipedia.org/wiki/Organization)'s process of defining its [strategy](http://en.wikipedia.org/wiki/Strategy), or direction, and making [decisions](http://en.wikipedia.org/wiki/Decision_making) on allocating its resources to pursue this strategy. In order to determine the direction of the organization, it is necessary to understand its current position and the possible avenues through which it can pursue a particular course of action. Generally, strategic planning deals with at least one of three key questions:

1. "What do we do?"
2. "For whom do we do it?"
3. "How do we excel?"

## Key components

The key components of 'strategic planning' include an understanding of the firm's vision, mission, values and strategies. The vision and mission are often captured in a Vision Statement and [Mission Statement](http://en.wikipedia.org/wiki/Mission_Statement).

* **Vision:** outlines what the organization wants to be, or how it wants the world in which it operates to be (an "idealised" view of the world). It is a long-term view and concentrates on the future. It can be emotive and is a source of inspiration. For example, a charity working with the poor might have a vision statement which reads "A World without Poverty."
* **Mission:** Defines the fundamental purpose of an organization or an enterprise, succinctly describing why it exists and what it does to achieve its vision. For example, the charity above might have a mission statement as "providing jobs for the homeless and unemployed".
* **Values:** Beliefs that are shared among the [stakeholders](http://en.wikipedia.org/wiki/Stakeholder_(corporate)) of an organization. Values drive an organization's culture and priorities and provide a framework in which decisions are made. For example, "Knowledge and skills are the keys to success" or "give a man bread and feed him for a day, but teach him to farm and feed him for life". These example values may set the priorities of self sufficiency over shelter.
* **Strategy:** Strategy, narrowly defined, means "the art of the general." A combination of the ends (goals) for which the firm is striving and the means (policies) by which it is seeking to get there. A strategy is sometimes called a roadmap which is the path chosen to plow towards the end vision. The most important part of implementing the strategy is ensuring the company is going in the right direction which is towards the end vision.

## Market segmentations

Target markets are groups of individuals separated by distinguishable and noticeable aspects. Target markets can be separated into:

• [Geographic](http://en.wikipedia.org/wiki/Geographic) segmentations, addresses (their location climate region)

• [Demographic](http://en.wikipedia.org/wiki/Demographic)/[socio-economic](http://en.wikipedia.org/wiki/Socio-economic) segmentation (gender, age, income, occupation, education, household size, and stage in the family life cycle)

• [Psychographic](http://en.wikipedia.org/wiki/Psychographic) segmentation (similar attitudes, values, and lifestyles)

• [Behavioural](http://en.wikipedia.org/wiki/Behavioral) segmentation (occasions, degree of loyalty)

• Product-related segmentation (relationship to a product)

## Criteria for Segmenting

An ideal **market segment** meets all of the following criteria:

* It is possible to measure.
* It has to be large enough to earn profit.
* It has to be stable enough that it does not vanish after some time.
* It is possible to reach potential customer via organization's promotion and distribution channel.
* It is internally homogeneous (potential customers in the same segment prefer the same product qualities).
* It is externally heterogeneous that is Heterogeneity between segments (potential customers from different segments have basically different quality preferences).
* It responds similarly to a market stimulus.
* It can be cost-efficiently reached by market intervention.
* useful in deciding on marketing mix

## Basis for segmenting consumer markets

### Geographic segmentation

The market is segmented according to geographic criteria- nations, states, regions, countries, cities, neighbourhoods, or zip codes. Geo-cluster approach combines demographic data with geographic data to create a more accurate profile of specific With aspect of region, in rainy regions you can sell things like raincoats, umbrellas and gumboots. In hot regions you can sell summer wear. In cold regions you can sell warm clothes

### Demographic Segmentation

Demographic segmentation consists of dividing the market into groups based on variables such as age, gender, family size, income, occupation, education, religion, race and nationality.

As you might expect, demographic segmentation variables are amongst the most popular bases for segmenting customer groups.

This is partly because customer wants are closely linked to variables such as income and age. Also, for practical reasons, there is often much more data available to help with the demographic segmentation process.

### Psychographic Segmentation

Psychographics is the science of using psychology and demographics to better understand consumers. Psychographic segmentation: Consumers are divided according to their lifestyle, personality, values. Aliens within the same demographic group can exhibit very different psychographic profiles.[[2]](http://en.wikipedia.org/wiki/Market_segmentation#cite_note-1)

### "Positive" market segmentation

Market segmenting is dividing the market into groups of individual markets with similar wants or needs that a company divides into distinct groups which have distinct needs, wants, behaviour or which might want different products & services. Broadly, markets can be divided according to a number of general criteria, such as by industry or public versus private. Although [industrial market segmentation](http://en.wikipedia.org/wiki/Industrial_market_segmentation) is quite different from consumer market segmentation, both have similar objectives. All of these methods of segmentation are merely proxies for true segments, which don't always fit into convenient demographic boundaries.

Consumer-based market segmentation can be performed on a *product specific* basis, to provide a close match between specific products and individuals. However, a number of generic market segment systems also exist, e.g. the system provides a broad segmentation of the population of the United States based on the statistical analysis of household and geodemographic data.

The process of segmentation is distinct from [positioning](http://en.wikipedia.org/wiki/Positioning_(marketing)) (designing an appropriate marketing mix for each segment). The overall intent is to identify groups of similar customers and potential customers; to prioritize the groups to address; to understand their behaviour; and to respond with appropriate marketing strategies that satisfy the different preferences of each chosen segment. Revenues are thus improved.

Improved segmentation can lead to significantly improved marketing effectiveness. Distinct segments can have different industry structures and thus have higher or lower attractiveness

Once a market segment has been identified (via segmentation), and targeted (in which the viability of servicing the market intended), the segment is then subject to positioning. Positioning involves ascertaining how a product or a company is perceived in the minds of consumers.

This part of the segmentation process consists of drawing up a perceptual map, which highlights rival goods within one's industry according to perceived quality and price. After the perceptual map has been devised, a firm would consider the marketing communications mix best suited to the product in question.

### Behavioural Segmentation

In behavioural segmentation, consumers are divided into groups according to their knowledge of, attitude towards, use of or response to a product. It is actually based on the behaviour of the consumer.

### Occasions

Segmentation according to occasions. We segment the market according to the occasions.

### Benefits

Segmentations according to benefits sought by the consumer.

## The marketing planning process

A marketing plan is a plan which outlines a company's overall marketing efforts. Marketing process can be realized by the marketing mix in step 4. The last step in the process is the marketing controlling.

The marketing plan can function from two points: strategy and tactics (P. Kotler, K.L. Keller). In most organizations, "strategic planning" is an annual process, typically covering just the year ahead. Occasionally, a few organizations may look at a practical plan which stretches three or more years ahead.

To be most effective, the plan has to be formalized, usually in written form, as a formal "marketing plan." The essence of the process is that it moves from the general to the specific, from the vision to the mission to the goals to the corporate objectives of the organization, then down to the individual [action plans](http://en.wikipedia.org/wiki/Objective_(goal)) for each part of the marketing program. It is also an interactive process, so that the draft output of each stage is checked to see what impact it has on the earlier stages, and is amended.

## Marketing strategy

**Marketing strategy** is a process that can allow an organization to concentrate its limited resources on the greatest opportunities to increase sales and achieve a sustainable [competitive advantage](http://en.wikipedia.org/wiki/Competitive_advantage).



## Developing a marketing strategy

Marketing strategies serve as the fundamental underpinning of [marketing plans](http://en.wikipedia.org/wiki/Marketing_plan) designed to fill market needs and reach [marketing](http://en.wikipedia.org/wiki/Marketing) objectives. Plans and objectives are generally tested for measurable results. Commonly, marketing strategies are developed as multi-year plans, with a tactical plan detailing specific actions to be accomplished in the current year. Time horizons covered by the [marketing plan](http://en.wikipedia.org/wiki/Marketing_plan) vary by company, by industry, and by nation, however, time horizons are becoming shorter as the speed of change in the environment increases. Marketing strategies are dynamic and interactive. They are partially planned and partially unplanned. See [strategy dynamics](http://en.wikipedia.org/wiki/Strategy_dynamics).

Marketing strategy involves careful scanning of the internal and external environments. Internal environmental factors include the [marketing mix](http://en.wikipedia.org/wiki/Marketing_mix), plus performance analysis and strategic constraints. External environmental factors include customer analysis, [competitor analysis](http://en.wikipedia.org/wiki/Competitor_analysis), [target market](http://en.wikipedia.org/wiki/Target_market) analysis, as well as evaluation of any elements of the technological, economic, cultural or political/legal environment likely to impact success. A key component of marketing strategy is often to keep marketing in line with a company's overarching [mission statement](http://en.wikipedia.org/wiki/Mission_statement).

Once a thorough environmental scan is complete, a [strategic plan](http://en.wikipedia.org/wiki/Strategic_planning) can be constructed to identify business alternatives, establish challenging goals, determine the optimal marketing mix to attain these goals, and detail implementation.[[3]](http://en.wikipedia.org/wiki/Strategic_marketing#cite_note-AakerDavid-2) A final step in developing a marketing strategy is to create a plan to monitor progress and a set of contingencies if problems arise in the implementation of the plan

## Competitor analysis

**Competitor analysis** in [marketing](http://en.wikipedia.org/wiki/Marketing) and strategic [management](http://en.wikipedia.org/wiki/Management) is an assessment of the strengths and weaknesses of current and potential [competitors](http://en.wikipedia.org/wiki/Competition_(economics)). This analysis provides both an offensive and defensive strategic context to identify opportunities and threats. Profiling coalesces all of the relevant sources of competitor analysis into one framework in the support of efficient and effective strategy formulation, implementation, monitoring and adjustment.

Competitor analysis is an essential component of corporate strategy. It is argued that most firms do not conduct this type of analysis systematically enough. Instead, many enterprises operate on what is called “informal impressions, conjectures, and intuition gained through the tidbits of information about competitors every manager continually receives.” As a result, traditional environmental scanning places many firms at risk of dangerous competitive blind spots due to a lack of robust competitor analysis.

## Market environment

The **market environment** is a [marketing](http://en.wikipedia.org/wiki/Marketing) term and refers to factors and forces that affect a firm’s ability to build and maintain successful relationships with customers. Three levels of the environment are: Micro (internal) environment - ma forces within the company that affect its ability to serve its customers. Meso environment – the industry in which a company operates and the industry’s market(s). Macro (national) environment - larger societal forces that affect the microenvironment.

## Micro-Environment (internal environment)

The microenvironment refers to the forces that are close to the company and affect its ability to serve its customers. It includes the company itself, its suppliers, marketing intermediaries, customer markets, [competitors](http://en.wikipedia.org/wiki/Competitors), and publics.

The company aspect of microenvironment refers to the internal environment of the company. This includes all [departments](http://en.wikipedia.org/wiki/Departmentalization), such as management, [finance](http://en.wikipedia.org/wiki/Finance), [research and development](http://en.wikipedia.org/wiki/Research_and_development), [purchasing](http://en.wikipedia.org/wiki/Purchasing), [operations](http://en.wikipedia.org/wiki/Business_operations) and [accounting](http://en.wikipedia.org/wiki/Accounting). Each of these departments has an impact on marketing decisions. For example, research and development have input as to the features a product can perform and accounting approves the financial side of marketing plans and budgets.

The [suppliers](http://en.wikipedia.org/wiki/Suppliers) of a company are also an important aspect of the microenvironment because even the slightest delay in receiving supplies can result in customer dissatisfaction. Marketing managers must watch supply availability and other trends dealing with suppliers to ensure that product will be delivered to customers in the time frame required in order to maintain a strong customer relationship.

Marketing intermediaries refers to resellers, physical distribution firms, marketing services agencies, and [financial intermediaries](http://en.wikipedia.org/wiki/Financial_intermediary). These are the people that help the company promote, sell, and distribute its products to final buyers. Resellers are those that hold and sell the company’s product. They match the distribution to the customers and include places such as [Wal-Mart](http://en.wikipedia.org/wiki/Wal-Mart), Target, and [Best Buy](http://en.wikipedia.org/wiki/Best_Buy). Physical distribution firms are places such as warehouses that store and transport the company’s product from its origin to its destination. Marketing services agencies are companies that offer services such as conducting [marketing research](http://en.wikipedia.org/wiki/Marketing_research), advertising, and consulting. Financial intermediaries are institutions such as banks, credit companies and [insurance companies](http://en.wikipedia.org/wiki/Insurance).

Another aspect of microenvironment is the customers. There are different types of customer markets including consumer markets, business markets, government markets, [international markets](http://en.wikipedia.org/wiki/Globalization), and reseller markets. The consumer market is made up of individuals who buy [goods and services](http://en.wikipedia.org/wiki/Goods_and_services) for their own personal use or use in their household. Business markets include those that buy goods and services for use in producing their own products to sell. This is different from the reseller market which includes businesses that purchase goods to resell as is for a profit. These are the same companies mentioned as market intermediaries. The government market consists of government agencies that buy goods to produce [public services](http://en.wikipedia.org/wiki/Public_services) or transfer goods to others who need them. International markets include buyers in other countries and includes customers from the previous categories.

Competitors are also a factor in the microenvironment and include companies with similar offerings for goods and services. To remain competitive a company must consider who their biggest competitors are while considering its own size and position in the industry. The company should develop a strategic advantage over their competitors.

The final aspect of the microenvironment is publics, which is any group that has an interest in or impact on the organization’s ability to meet its goals. For example, financial publics can hinder a company’s ability to obtain funds affecting the level of credit a company has. Media publics include newspapers and magazines that can publish articles of interest regarding the company and editorials that may influence customers’ opinions. Government publics can affect the company by passing legislation and laws that put restrictions on the company’s actions. Citizen-action publics include environmental groups and [minority groups](http://en.wikipedia.org/wiki/Minority_group) and can question the actions of a company and put them in the public spotlight. Local publics are neighborhood and community organizations and will also question a company’s impact on the local area and the level of responsibility of their actions. The general public can greatly affect the company as any change in their attitude, whether positive or negative, can cause sales to go up or down because the general public is often the company’s [customer base](http://en.wikipedia.org/wiki/Customer_base). And finally those who are employed within the company and deal with the organization and construction of the company’s product.

## Macro-Environment (external environment)

The macroenvironment refers to all forces that are part of the larger society and affect the microenvironment. It includes concepts such as demography, economy, natural forces, technology, politics, and culture.

[Demography](http://en.wikipedia.org/wiki/Demography) refers to studying human populations in terms of size, density, location, age, gender, race, and occupation. This is a very important factor to study for marketers and helps to divide the population into [market segments](http://en.wikipedia.org/wiki/Market_segment) and [target markets](http://en.wikipedia.org/wiki/Target_market). An example of demography is classifying groups of people according to the year they were born. These classifications can be referred to as [baby boomers](http://en.wikipedia.org/wiki/Baby_boomer), who are born between 1946 and 1964, [generation X](http://en.wikipedia.org/wiki/Generation_X), who are born between 1965 and 1976, and [generation Y](http://en.wikipedia.org/wiki/Generation_Y), who are born between 1977 and 1994. Each classification has different characteristics and causes they find important. This can be beneficial to a marketer as they can decide who their product would benefit most and tailor their [marketing plan](http://en.wikipedia.org/wiki/Marketing_plan) to attract that segment. Demography covers many aspects that are important to marketers including family dynamics, geographic shifts, work force changes, and levels of diversity in any given area.

Another aspect of the macroenvironment is the economic environment. This refers to the [purchasing power](http://en.wikipedia.org/wiki/Purchasing_power) of potential customers and the ways in which people spend their money. Within this area are two different economies, subsistence and industrialized. Subsistence economies are based more in agriculture and consume their own industrial output. Industrial economies have markets that are diverse and carry many different types of goods. Each is important to the marketer because each has a highly different spending pattern as well as different [distribution of wealth](http://en.wikipedia.org/wiki/Distribution_of_wealth).

The natural environment is another important factor of the macroenvironment. This includes the natural resources that a company uses as inputs and affects their marketing activities. The concern in this area is the increased pollution, shortages of raw materials and increased governmental intervention. As raw materials become increasingly scarcer, the ability to create a company’s product gets much harder. Also, pollution can go as far as negatively affecting a company’s reputation if they are known for damaging the environment. The last concern, [government intervention](http://en.wikipedia.org/wiki/Public_sector) can make it increasingly harder for a company to fulfill their goals as requirements get more stringent.

The technological environment is perhaps one of the fastest changing factors in the macroenvironment. This includes all developments from antibiotics and surgery to [nuclear missiles](http://en.wikipedia.org/wiki/Nuclear_weapons_delivery) and [chemical weapons](http://en.wikipedia.org/wiki/Chemical_warfare) to automobiles and [credit cards](http://en.wikipedia.org/wiki/Credit_card). As these markets develop it can create new markets and new uses for products. It also requires a company to stay ahead of others and update their own technology as it becomes outdated. They must stay informed of trends so they can be part of the next big thing, rather than becoming outdated and suffering the consequences financially.

The political environment includes all [laws](http://en.wikipedia.org/wiki/Laws), [government agencies](http://en.wikipedia.org/wiki/Government_agencies), and groups that influence or limit other organizations and individuals within a [society](http://en.wikipedia.org/wiki/Society). It is important for marketers to be aware of these restrictions as they can be complex. Some products are regulated by both state and federal laws. There are even restrictions for some products as to who the target market may be, for example, cigarettes should not be marketed to younger children. There are also many restrictions on [subliminal messages](http://en.wikipedia.org/wiki/Subliminal_message) and monopolies. As laws and regulations change often, this is a very important aspect for a marketer to monitor.

The final aspect of the macroenvironment is the cultural environment, which consists of institutions and basic values and beliefs of a group of people. The values can also be further categorized into core beliefs, which passed on from generation to generation and very difficult to change, and secondary beliefs, which tend to be easier to influence. As a marketer, it is important to know the difference between the two and to focus your marketing campaign to reflect the values of a [target audience](http://en.wikipedia.org/wiki/Target_audience).

When dealing with the marketing environment it is important for a company to become proactive. By doing so, they can create the kind of environment that they will prosper in and can become more efficient by marketing in areas with the greatest customer potential. It is important to place equal emphasis on both the macro and microenvironment and to react accordingly to changes within them.[[2]](http://en.wikipedia.org/wiki/Market_environment#cite_note-1)

## Consumer behaviour

**Consumer behaviour** is the study of when, why, how, and where people do or do not buy a [product](http://en.wikipedia.org/wiki/Product_(business)). It blends elements from [psychology](http://en.wikipedia.org/wiki/Psychology), [sociology](http://en.wikipedia.org/wiki/Sociology), [social](http://en.wikipedia.org/wiki/Social_Anthropology) [anthropology](http://en.wikipedia.org/wiki/Anthropology) and [economics](http://en.wikipedia.org/wiki/Economics). It attempts to understand the buyer decision making process, both individually and in groups. It studies characteristics of individual consumers such as [demographics](http://en.wikipedia.org/wiki/Demographic) and behavioural variables in an attempt to understand people's wants. It also tries to assess influences on the [consumer](http://en.wikipedia.org/wiki/Consumer) from groups such as family, friends, reference groups, and society in general.

Customer behaviour study is based on consumer buying behaviour, with the customer playing the three distinct roles of user, payer and buyer. Research has shown that consumer behaviour is difficult to predict, even for experts in the field. [Relationship marketing](http://en.wikipedia.org/wiki/Relationship_marketing) is an influential asset for customer behaviour analysis as it has a keen interest in the re-discovery of the true meaning of marketing through the re-affirmation of the importance of the customer or buyer. A greater importance is also placed on consumer retention, customer relationship management, personalisation, customisation and one-to-one marketing. Social functions can be categorized into social choice and welfare functions.

Each method for vote counting is assumed as social function but if [Arrow’s possibility theorem](http://en.wikipedia.org/wiki/Arrow%27s_impossibility_theorem) is used for a social function, social welfare function is achieved. Some specifications of the social functions are decisiveness, [neutrality](http://en.wikipedia.org/wiki/Neutrality), [anonymity](http://en.wikipedia.org/wiki/Anonymity), [monotonicity](http://en.wikipedia.org/wiki/Monotonicity), [unanimity](http://en.wikipedia.org/wiki/Unanimity), homogeneity and weak and strong [Pareto optimality](http://en.wikipedia.org/wiki/Pareto_optimality). No social choice function meets these requirements in an ordinal scale simultaneously. The most important characteristic of a social function is identification of the interactive effect of alternatives and creating a logical relation with the ranks. Marketing provides services in order to satisfy customers. With that in mind, the productive system is considered from its beginning at the production level, to the end of the cycle, the consumer

## Buying behaviour

A marketing firm must ascertain the nature of customers' buying behaviour if it is to market its product properly. In order to entice and persuade a consumer to buy a product, marketers try to determine the behavioural process of how a given product is purchased. Buying behaviour is usually split into two prime strands, whether selling to the consumer, known as [business-to-consumer](http://en.wikipedia.org/wiki/Business-to-consumer) (B2C), or to another business, known as [business-to-business](http://en.wikipedia.org/wiki/Business-to-business) (B2B).

### B2C buying behaviour

This mode of behaviour concerns consumers and their purchase of a given product. For example, if one imagines a pair of sneakers, the desire for a pair of sneakers would be followed by an information search on available types/brands. This may include perusing media outlets, but most commonly consists of information gathered from family and friends. If the information search is insufficient, the consumer may search for alternative means to satisfy the need/want. In this case, this may mean buying leather shoes, sandals, etc. The purchase decision is then made, in which the consumer actually buys the product. Following this stage, a post-purchase evaluation is often conducted, comprising an appraisal of the value/utility brought by the purchase of the sneakers. If the value/utility is high, then a repeat purchase may be made. This could then develop into consumer loyalty to the firm producing the sneakers.

### B2B buying behaviour

Relates to organizational/industrial buying behaviour. Business buy either wholesale from other businesses or directly from the manufacturer in contracts or agreements. B2B marketing involves one business marketing a product or service to another business. B2C and B2B behaviour are not precise terms, as similarities and differences exist, with some key differences listed below:

In a straight re-buy, the fourth, fifth and sixth stages are omitted. In a modified re-buy scenario, the fifth and sixth stages are precluded. In a new buy, all stages are conducted

## Marketing mix

The **marketing mix** is a business tool used in [marketing](http://en.wikipedia.org/wiki/Marketing) products. The marketing mix is often crucial when determining a product or brand's unique selling point (the unique quality that differentiates a product from its competitors), and is often synonymous with the **four Ps**: *price*, *product*, *promotion*, and *place*.

## Four Ps: the producer-oriented model

The marketer, [E. Jerome McCarthy](http://en.wikipedia.org/wiki/E._Jerome_McCarthy), proposed a four Ps classification in 1960, which has since been used by marketers throughout the world

* [Product](http://en.wikipedia.org/wiki/Product_(business)) - A product is seen as an item that satisfies what a consumer needs or wants. It is a tangible good or an intangible service. Intangible products are service based like the [tourism industry](http://en.wikipedia.org/wiki/Tourism_industry), the [hotel industry](http://en.wikipedia.org/wiki/Hotel_industry) and the [financial industry](http://en.wikipedia.org/wiki/Financial_industry). Tangible products are those that have an independent physical existence. Typical examples of mass-produced, tangible objects are the [motor car](http://en.wikipedia.org/wiki/Motor_car) and the disposable [razor](http://en.wikipedia.org/wiki/Razor). A less obvious but ubiquitous mass produced service is a [computer operating system](http://en.wikipedia.org/wiki/Computer_operating_system).

Every product is subject to a [life-cycle](http://en.wikipedia.org/wiki/Product_life-cycle_theory) including a growth phase followed by a maturity phase and finally an eventual period of decline as sales falls. Marketers must do careful research on how long the life cycle of the product they are marketing is likely to be and focus their attention on different challenges that arise as the product moves through each stage.

The marketer must also consider the [product mix](http://en.wikipedia.org/wiki/Product_lining). Marketers can expand the current product mix by increasing a certain product line's depth or by increasing the number of product lines. Marketers should consider how to position the product, how to exploit the brand, how to exploit the company's resources and how to configure the product mix so that each product complements the other. The marketer must also consider product development strategies.

* [Price](http://en.wikipedia.org/wiki/Pricing) – The price is the amount a customer pays for the product. The price is very important as it determines the company's profit and hence, survival. Adjusting the price has a profound impact on the marketing strategy, and depending on the [price elasticity](http://en.wikipedia.org/wiki/Price_elasticity) of the product, often; it will affect the [demand](http://en.wikipedia.org/wiki/Demand) and sales as well. The marketer should set a price that complements the other elements of the marketing mix.

When setting a price, the marketer must be aware of the [customer perceived value](http://en.wikipedia.org/wiki/Customer_perceived_value) for the product. Three basic pricing strategies are: [market skimming](http://en.wikipedia.org/wiki/Market_skimming) pricing, marketing [penetration pricing](http://en.wikipedia.org/wiki/Penetration_pricing) and neutral pricing. The 'reference value' (where the consumer refers to the prices of competing products) and the 'differential value' (the consumer's view of this product's attributes versus the attributes of other products) must be taken into account.

* [Promotion](http://en.wikipedia.org/wiki/Promotion_(marketing)) - represents all of the methods of communication that a marketer may use to provide information to different parties about the product. Promotion comprises elements such as: [advertising](http://en.wikipedia.org/wiki/Advertising), [public relations](http://en.wikipedia.org/wiki/Public_relations), [personal selling](http://en.wikipedia.org/wiki/Personal_selling) and [sales promotion](http://en.wikipedia.org/wiki/Sales_promotion).

Advertising covers any communication that is paid for, from cinema commercials, radio and Internet advertisements through print media and billboards. Public relations is where the communication is not directly paid for and includes press releases, sponsorship deals, exhibitions, conferences, seminars or trade fairs and events. [Word-of-mouth](http://en.wikipedia.org/wiki/Word_of_mouth) is any apparently informal communication about the product by ordinary individuals, satisfied customers or people specifically engaged to create word of mouth momentum. Sales staff often plays an important role in word of mouth and public relations (see 'product' above).

* [Place](http://en.wikipedia.org/wiki/Product_placement) - refers to providing the product at a place which is convenient for consumers to access. Place is synonymous with [distribution](http://en.wikipedia.org/wiki/Distribution_(business)). Various [strategies](http://en.wikipedia.org/wiki/Distribution_(business)#Type_of_marketing_channel) such as intensive distribution, selective distribution, exclusive distribution and [franchising](http://en.wikipedia.org/wiki/Franchising) can be used by the marketer to complement the other aspects of the marketing mix.

## Elements of the global marketing mix

The “Four P’s” of marketing: product, price, placement, and promotion are all affected as a company moves through the five evolutionary phases to become a global company. Ultimately, at the global marketing level, a company trying to speak with one voice is faced with many challenges when creating a worldwide marketing plan. Unless a company holds the same position against its competition in all markets (market leader, low cost, etc.) it is impossible to launch identical marketing plans worldwide. Nisant Chakram (Marketing Management)

### Product

A global company is one that can create a single product and only have to tweak elements for different markets. For example, [Coca-Cola](http://en.wikipedia.org/wiki/Coca-Cola) uses two formulas (one with sugar, one with corn syrup) for all markets. The product packaging in every country incorporates the contour bottle design and the dynamic ribbon in some way, shapes, or form. However, the bottle can also include the country’s native language and is the same size as other beverage bottles or cans in that same country.

### Price

Price will always vary from market to market. Price is affected by many variables: cost of product development (produced locally or imported), cost of ingredients, cost of delivery (transportation, tariffs, etc.), and much more. Additionally, the product’s position in relation to the competition influences the ultimate profit margin. Whether this product is considered the high-end, expensive choice, the economical, low-cost choice, or something in-between helps determine the price point.

### Placement

How the product is distributed is also a country-by-country decision influenced by how the competition is being offered to the target market. Using Coca-Cola as an example again, not all cultures use vending machines. In the United States, beverages are sold by the pallet via warehouse stores. In India, this is not an option. Placement decisions must also consider the product’s position in the market place. For example, a high-end product would not want to be distributed via a “dollar store” in the United States. Conversely, a product promoted as the low-cost option in France would find limited success in a pricey boutique.

### Promotion

After product research, development and creation, promotion (specifically advertising) is generally the largest line item in a global company’s marketing budget. At this stage of a company’s development, integrated marketing is the goal. The global corporation seeks to reduce costs, minimize redundancies in personnel and work, maximize speed of implementation, and to speak with one voice. If the goal of a global company is to [send the same message worldwide](http://en.wikipedia.org/wiki/Global_Marketing), then delivering that message in a relevant, engaging, and cost-effective way is the challenge.

Effective global advertising techniques do exist. The key is testing advertising ideas using a marketing research system proven to provide results that can be compared across countries. The ability to identify which elements or moments of an ad are contributing to that success is how economies of scale are maximized. Market research measures such as [Flow of Attention](http://en.wikipedia.org/w/index.php?title=Flow_of_Attention&action=edit&redlink=1), [Flow of Emotion](http://en.wikipedia.org/w/index.php?title=Flow_of_Emotion&action=edit&redlink=1) and [branding moments](http://en.wikipedia.org/w/index.php?title=Branding_moment&action=edit&redlink=1) provide insights into what is working in an ad in any country because the measures are based on visual, not verbal, elements of the ad.

## Promotional mix

There are five main aspects of a **promotional mix**. These are:

* [***Advertising***](http://en.wikipedia.org/wiki/Advertising) - Presentation and promotion of ideas, goods, or services by an identified sponsor. *Examples: Print ads, radio, television, billboard, direct mail, brochures and catalogs, signs, in-store displays, posters, motion pictures, Web pages, banner ads, and emails.* (Always in Paid Form non personal)
* [***Personal selling***](http://en.wikipedia.org/wiki/Personal_selling) - A process of helping and persuading one or more prospects to purchase a good or service or to act on any idea through the use of an oral presentation. *Examples: Sales presentations, sales meetings, sales training and incentive programs for intermediary salespeople, samples, and telemarketing. Can be face-to-face or via telephone.*
* [***Sales promotion***](http://en.wikipedia.org/wiki/Sales_promotion) - Media and non-media marketing communication are employed for a pre-determined, limited time to increase consumer demand, stimulate market demand or improve product availability. *Examples: Coupons, sweepstakes, contests, product samples, rebates, tie-ins, self-liquidating premiums, trade shows, trade-ins, and exhibitions.*
* [***Public relations***](http://en.wikipedia.org/wiki/Public_relations) - Paid intimate stimulation of supply for a product, service, or business unit by planting significant news about it or favourable presentation of it in the media. *Examples: Newspaper and magazine articles/reports, TVs and radio presentations, charitable contributions, speeches, issue advertising, and seminars.*
* [***Direct Marketing***](http://en.wikipedia.org/wiki/Direct_Marketing) is a channel-agnostic form of advertising that allows businesses and nonprofits to communicate straight to the customer, with advertising techniques such as mobile messaging, email, interactive consumer websites, online display ads, fliers, catalog distribution, promotional letters, and outdoor advertising.

[***Corporate image***](http://en.wikipedia.org/wiki/Corporate_image) Corporate image may also be considered as the sixth aspect of promotion mix. The Image of an organization is a crucial point in marketing. If the reputation of a company is bad, consumers are less willing to buy a product from this company as they would have been, if the company had a good image. [***Sponsorship***](http://en.wikipedia.org/wiki/Sponsor_(commercial)) is sometimes added as a seventh aspect.

## Mission statement

A **mission statement** is a statement of the purpose of a [company](http://en.wikipedia.org/wiki/Company) or [organization](http://en.wikipedia.org/wiki/Organization). The mission statement should guide the actions of the organization, spell out its overall goal, provide a path, and guide decision-making. It provides "the framework or context within which the company's strategies are formulated."

## Contents

Effective mission statements commonly clarify the organization’s purpose and also ultimately seek to justify the organization's reason for existing.

Commercial mission statements often include the following information:

* Purpose and aim(s) of the organization
* The organization's primary stakeholders: clients/customers, shareholders, congregation, etc.
* How the organization provides value to these stakeholders, for example by offering specific types of products and/or services

According to Bart the commercial mission statement consists of 3 essential components:

1. Key market – who is your target client/customer? (generalize if needed)
2. Contribution – what product or service do you provide to that client?
3. Distinction – what makes your product or service unique, so that the client would choose you?

Examples of mission statements that clearly include the 3 essential components:

For example:

* McDonalds - "To provide the fast food customer food prepared in the same high-quality manner world-wide that is tasty, reasonably-priced & delivered consistently in a low-key décor and friendly atmosphere."
  + Key Market: The fast food customer world-wide
  + Contribution: tasty and reasonably-priced food prepared in a high-quality manner
  + Distinction: delivered consistently (world-wide) in a low-key décor and friendly atmosphere.
* Courtyard by Marriott - "To provide economy and quality minded travellers with a premier, moderate priced lodging facility which is consistently perceived as clean, comfortable, well-maintained, and attractive, staffed by friendly, attentive and efficient people
  + Key Market: economy and quality minded travellers
  + Contribution: moderate priced lodging
  + Distinction: consistently perceived as clean, comfortable, well-maintained, and attractive, staffed by friendly, attentive and efficient people

The mission statement can be used to resolve trade-offs between different business [stakeholders](http://en.wikipedia.org/wiki/Stakeholder_(corporate)). Stakeholders include: managers & executives, non-management employees, shareholders, board of directors, customers, suppliers, distributors, creditors/bankers, governments (local, state, federal, etc.), labour unions, competitors, [NGOs](http://en.wikipedia.org/wiki/Non-governmental_organization), and the community or general public. By definition, stakeholders affect or are affected by the organization's decisions and activities.

According to Vern McGinnisa mission should:

* Define what the company is
* Limited to exclude some ventures
* Broad enough to allow for creative growth
* Distinguish the company from all others
* Serve as framework to evaluate current activities
* Stated clearly so that it is understood by all

## Vision statement

**A vision statement** is sometimes called a picture of your company in the future but it’s so much more than that. Your vision statement is your inspiration, the framework for all your strategic planning. A vision statement may apply to an entire company or to a single division of that company. Whether for all or part of an organization, the vision statement answers the question, "Where do we want to go?" What you are doing when creating a vision statement is articulating your dreams and hopes for your business. It reminds you of what you are trying to build. While a vision statement doesn't tell you how you're going to get there, it does set the direction for your [business planning](http://sbinfocanada.about.com/od/businessplanning/g/bizplanning.htm). (For more on the role of your vision statement in business planning, see [Quick-Start Business Planning](http://sbinfocanada.about.com/od/businessplanning/a/fastbizplanning.htm).) That's why it's important when crafting a vision statement to let your imagination go and dare to dream – and why it’s important that a vision statement captures your passion.

Unlike the [mission statement](http://sbinfocanada.about.com/od/businessplanning/g/missionstatemen.htm), a vision statement is for you and the other members of your company, not for your customers or clients. When writing a vision statement, your mission statement and your [core competencies](http://sbinfocanada.about.com/od/management/g/corecompetence.htm) can be a valuable starting point for articulating your values. Be sure when you're creating one not to fall into the trap of only thinking ahead a year or two. Once you have one, your vision statement will have a huge influence on decision making and the way you allocate resources.

<http://sbinfocanada.about.com/od/businessplanning/g/visionstatement.htm>

## PEST analysis

**PEST analysis** stands for "**P**olitical, **E**conomic, **S**ocial, and **T**echnological analysis" and describes a framework of macro-environmental factors used in the [environmental scanning](http://en.wikipedia.org/wiki/Environmental_scanning) component of [strategic management](http://en.wikipedia.org/wiki/Strategic_management). Some analysts added **L**egal and rearranged the mnemonic to SLEPT;[[1]](http://en.wikipedia.org/wiki/PESTLE_analysis#cite_note-0) inserting **E**nvironmental factors expanded it to PESTEL or PESTLE, which is popular in the United Kingdom.[[2]](http://en.wikipedia.org/wiki/PESTLE_analysis#cite_note-1) The model has recently been further extended to STEEPLE and STEEPLED, adding Ethics and [demographic](http://en.wikipedia.org/wiki/Demographics) factors. It is a part of the external analysis when conducting a strategic analysis or doing [market research](http://en.wikipedia.org/wiki/Market_research), and gives an overview of the different macroenvironmental factors that the company has to take into consideration. It is a useful strategic tool for understanding market growth or decline, business position, potential and direction for operations. The growing importance of environmental or ecological factors in the first decade of the 21st century have given rise to [green business](http://en.wikipedia.org/wiki/Green_business) and encouraged widespread use of an updated version of the PEST framework. STEER analysis systematically considers Socio-cultural, Technological, Economic, Ecological, and Regulatory factors.



## Composition

* **Political** factors are how and to what degree a [government](http://en.wikipedia.org/wiki/Government) intervenes in the economy. Specifically, political factors include areas such as [tax policy](http://en.wikipedia.org/wiki/Tax_policy), [labour law](http://en.wikipedia.org/wiki/Labour_law), [environmental law](http://en.wikipedia.org/wiki/Environmental_law), [trade restrictions](http://en.wikipedia.org/wiki/Trade_restriction), [tariffs](http://en.wikipedia.org/wiki/Tariffs), and political stability. Political factors may also include goods and services which the government wants to provide or be provided ([merit goods](http://en.wikipedia.org/wiki/Merit_good)) and those that the government does not want to be provided ([demerit goods](http://en.wikipedia.org/wiki/Demerit_good) or merit bads). Furthermore, governments have great influence on the [health](http://en.wikipedia.org/wiki/Health), [education](http://en.wikipedia.org/wiki/Education), and [infrastructure](http://en.wikipedia.org/wiki/Infrastructure) of a nation
* **Economic** factors include [economic growth](http://en.wikipedia.org/wiki/Economic_growth), [interest rates](http://en.wikipedia.org/wiki/Interest_rate), [exchange rates](http://en.wikipedia.org/wiki/Exchange_rate) and the [inflation rate](http://en.wikipedia.org/wiki/Inflation_rate). These factors have major impacts on how businesses operate and make decisions. For example, interest rates affect a firm's [cost of capital](http://en.wikipedia.org/wiki/Cost_of_capital) and therefore to what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy
* **Social** factors include the cultural aspects and include health consciousness, population growth rate, age distribution, career attitudes and emphasis on safety. Trends in social factors affect the demand for a company's products and how that company operates. For example, an aging population may imply a smaller and less-willing workforce (thus increasing the cost of labor). Furthermore, companies may change various management strategies to adapt to these social trends (such as recruiting older workers).
* **Technological** factors include technological aspects such as [R&D](http://en.wikipedia.org/wiki/R%26D) activity, [automation](http://en.wikipedia.org/wiki/Automation), technology incentives and the rate of [technological change](http://en.wikipedia.org/wiki/Technological_change). They can determine [barriers to entry](http://en.wikipedia.org/wiki/Barrier_to_entry), minimum efficient production level and influence [outsourcing](http://en.wikipedia.org/wiki/Outsourcing) decisions. Furthermore, technological shifts can affect costs, quality, and lead to [innovation](http://en.wikipedia.org/wiki/Innovation).
* **Environmental** factors include ecological and environmental aspects such as weather, climate, and [climate change](http://en.wikipedia.org/wiki/Climate_change), which may especially affect industries such as tourism, farming, and insurance. Furthermore, growing awareness of the potential impacts of climate change is affecting how companies operate and the products they offer, both creating new markets and diminishing or destroying existing ones.
* **Legal** factors include [discrimination law](http://en.wikipedia.org/wiki/Discrimination_law), [consumer law](http://en.wikipedia.org/wiki/Consumer_law), [antitrust law](http://en.wikipedia.org/wiki/Antitrust_law), [employment law](http://en.wikipedia.org/wiki/Employment_law), and [health and safety law](http://en.wikipedia.org/wiki/Health_and_safety_law). These factors can affect how a company operates, its costs, and the demand for its products.

## Applicability of the Factors

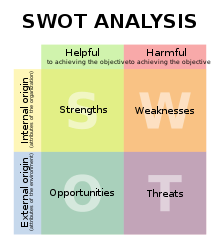
The model's factors will vary in importance to a given company based on its industry and the goods it produces. For example, consumer and [B2B](http://en.wikipedia.org/wiki/Business-to-business) companies tend to be more affected by the social factors, while a global defense contractor would tend to be more affected by political factors.[[3]](http://en.wikipedia.org/wiki/PESTLE_analysis#cite_note-2) Additionally, factors that are more likely to change in the future or more relevant to a given company will carry greater importance. For example, a company which has borrowed heavily will need to focus more on the economic factors (especially interest rates).[[4]](http://en.wikipedia.org/wiki/PESTLE_analysis#cite_note-Oxford-3)

Furthermore, conglomerate companies who produce a wide range of products (such as Sony, Disney, or BP) may find it more useful to analyze one department of its company at a time with the PESTEL model, thus focusing on the specific factors relevant to that one department. A company may also wish to divide factors into geographical relevance, such as local, national, and global (also known as LONGPESTEL).

## Use of PEST analysis with other models

The PEST factors, combined with external micro-environmental factors and internal drivers, can be classified as opportunities and threats in a [SWOT analysis](http://en.wikipedia.org/wiki/SWOT_analysis).

## SWOT analysis

[](http://en.wikipedia.org/wiki/File:SWOT_en.svg)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:SWOT_en.svg)

SWOT analysis, with its four elements in a 2x2 matrix.

**SWOT analysis** (alternately **SLOT analysis**) is a [strategic planning](http://en.wikipedia.org/wiki/Strategic_planning) method used to evaluate the **S**trengths, **W**eaknesses/Limitations, **O**pportunities, and **T**hreats involved in a [project](http://en.wikipedia.org/wiki/Project) or in a [business](http://en.wikipedia.org/wiki/Business) venture. It involves specifying the objective of the business venture or project and identifying the internal and external factors that are favourable and unfavourable to achieve that objective. The technique is credited to [Albert Humphrey](http://en.wikipedia.org/wiki/Albert_S._Humphrey), who led a convention at the Stanford Research Institute (now [SRI International](http://en.wikipedia.org/wiki/SRI_International)) in the 1960s and 1970s using data from [Fortune 500](http://en.wikipedia.org/wiki/Fortune_500) companies.

Setting the objective should be done after the SWOT analysis has been performed. This would allow achievable goals or objectives to be set for the organization.

* **S**trengths: characteristics of the business, or project team that give it an advantage over others
* **W**eaknesses (or Limitations): are characteristics that place the team at a disadvantage relative to others
* **O**pportunities: *external* chances to improve performance (e.g. make greater profits) in the environment
* **T**hreats: *external* elements in the environment that could cause trouble for the business or project

Identification of SWOTs is essential because subsequent steps in the process of planning for achievement of the selected objective may be derived from the SWOTs.

First, the decision makers have to determine whether the objective is attainable, given the SWOTs. If the objective is NOT attainable a different objective must be selected and the process repeated.

Users of SWOT analysis need to ask and answer questions that generate meaningful information for each category (strengths, opportunities, weaknesses, and threats) in order to maximize the benefits of this evaluation and find their competitive advantage.

## Porter five forces analysis

[](http://en.wikipedia.org/wiki/File:Porters_five_forces.PNG)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Porters_five_forces.PNG)

A graphical representation of Porter's Five Forces

**Porter's five forces analysis** is a framework for industry analysis and business strategy development formed by [Michael E. Porter](http://en.wikipedia.org/wiki/Michael_Porter) of [Harvard Business School](http://en.wikipedia.org/wiki/Harvard_Business_School) in 1979. It draws upon [industrial organization (IO) economics](http://en.wikipedia.org/wiki/Industrial_organization) to derive five forces that determine the competitive intensity and therefore attractiveness of a [market](http://en.wikipedia.org/wiki/Market). Attractiveness in this context refers to the overall industry profitability. An "unattractive" industry is one in which the combination of these five forces acts to drive down overall profitability. A very unattractive industry would be one approaching "pure competition", in which available profits for all firms are driven to [normal profit](http://en.wikipedia.org/wiki/Profit_(economics)#Normal_profit).

Three of Porter's five forces refer to competition from external sources. The remainder are internal threats.

Porter referred to these forces as the [micro environment](http://en.wikipedia.org/wiki/Marketing#Marketing_environment), to contrast it with the more general term [macro environment](http://en.wikipedia.org/wiki/Environmental_scanning). They consist of those forces close to a [company](http://en.wikipedia.org/wiki/Company) that affect its ability to serve its customers and make a [profit](http://en.wikipedia.org/wiki/Profit_(economics)). A change in any of the forces normally requires a business unit to re-assess the [marketplace](http://en.wikipedia.org/wiki/Marketplace) given the overall change in [industry information](http://en.wikipedia.org/wiki/Industry_information). The overall industry attractiveness does not imply that every [firm](http://en.wikipedia.org/wiki/Firm) in the industry will return the same profitability. Firms are able to apply their [core competencies](http://en.wikipedia.org/wiki/Core_competencies), [business model](http://en.wikipedia.org/wiki/Business_model) or network to achieve a profit above the industry average. A clear example of this is the airline [industry](http://en.wikipedia.org/wiki/Industry). As an industry, profitability is low and yet individual companies, by applying unique business models, have been able to make a return in excess of the industry average.

Porter's five forces include - three forces from 'horizontal' competition: threat of substitute products, the threat of established rivals, and the threat of new entrants; and two forces from 'vertical' competition: the [bargaining power](http://en.wikipedia.org/wiki/Bargaining_power) of suppliers and the bargaining power of customers.

This five forces analysis is just one part of the complete Porter strategic models. The other elements are the [value chain](http://en.wikipedia.org/wiki/Value_chain) and the [generic strategies](http://en.wikipedia.org/wiki/Porter_generic_strategies).

Porter developed his Five Forces analysis in reaction to the then-popular [SWOT analysis](http://en.wikipedia.org/wiki/SWOT_analysis), which he found unrigorous and *ad hoc*. Porter's five forces are based on the Structure-Conduct-Performance paradigm in industrial organizational economics. It has been applied to a diverse range of problems, from helping businesses become more profitable to helping governments stabilize industries.

**Five forces**

### 1. Threat of new competition

### 2. Threat of substitute products or services

### 3. Bargaining power of customers (buyers)

### 4. Bargaining power of suppliers

**5. Intensity of competitive rivalry**

## Public relations

**Public relations -** (PR) is the practice of managing the flow of [information](http://en.wikipedia.org/wiki/Information) between an individual or an [organization](http://en.wikipedia.org/wiki/Organization) and the [public](http://en.wikipedia.org/wiki/Public). Public relations is the deliberate, planned, and sustained effort to establish and maintain a preferred point of view. Public relations provide an organization or [individual](http://en.wikipedia.org/wiki/Individual) [exposure](http://en.wikipedia.org/wiki/Publicity) to their audiences using topics of public interest and news items that do not require direct payment. The aim of public relations by a company often is to persuade the public, investors, partners, employees, and other stakeholders to maintain a certain point of view about it, its leadership, products, or of political decisions. Common activities include speaking at conferences, winning industry awards, working with the press, and employee communication

Specific public relations disciplines include:

* Financial public relations – providing information mainly to business [reporters](http://en.wikipedia.org/wiki/Reporter)
* Consumer/lifestyle public relations – gaining publicity for a particular product or service, rather than using [advertising](http://en.wikipedia.org/wiki/Advertising)
* Crisis public relations – responding to negative accusations or information
* Industry relations – providing information to [trade bodies](http://en.wikipedia.org/wiki/Trade_bodies)
* Government relations – engaging government departments to influence policymaking

Other public relations activities include:

* Publicity events, [pseudo-events](http://en.wikipedia.org/wiki/Pseudo-event), [photo ops](http://en.wikipedia.org/wiki/Photo_op) or [publicity stunts](http://en.wikipedia.org/wiki/Publicity_stunt)
* Speeches to constituent groups and professional organizations; receptions; seminars, and other events; personal appearances
* [Talk show](http://en.wikipedia.org/wiki/Talk_show) circuit: a public relations spokesperson, or the client, "does the circuit" by being interviewed on television and radio talk shows with audiences that the client wishes to reach
* Books and other writings
* Collateral literature, both offline and online
* Direct communication (carrying messages directly to audiences, rather than via the mass media) with, for example, printed or email newsletters
* [Blogs](http://en.wikipedia.org/wiki/Blogs)
* Social media and social networks

## Advertising

**Advertising** is a form of [communication](http://en.wikipedia.org/wiki/Communication) used to encourage or [persuade](http://en.wikipedia.org/wiki/Persuade) an audience (viewers, readers or listeners; sometimes a specific group of people) to continue or take some new action. Most commonly, the desired result is to drive consumer behaviour with respect to a commercial offering, although political and ideological advertising is also common. The purpose of advertising may also be to reassure employees or shareholders that a company is viable or successful. Advertising messages are usually paid for by [sponsors](http://en.wikipedia.org/wiki/Sponsor_(commercial)) and viewed via various [traditional media](http://en.wikipedia.org/wiki/Traditional_media); including [mass media](http://en.wikipedia.org/wiki/Mass_media) such as [newspaper](http://en.wikipedia.org/wiki/Newspaper), [magazines](http://en.wikipedia.org/wiki/Magazines), [television commercial](http://en.wikipedia.org/wiki/Television_commercial), [radio advertisement](http://en.wikipedia.org/wiki/Radio_advertisement), [outdoor advertising](http://en.wikipedia.org/wiki/Outdoor_advertising) or [direct mail](http://en.wikipedia.org/wiki/Direct_mail); or [new media](http://en.wikipedia.org/wiki/New_media) such as [blogs](http://en.wikipedia.org/wiki/Blog), [websites](http://en.wikipedia.org/wiki/Website) or [text messages](http://en.wikipedia.org/wiki/Text_messaging).

Commercial advertisers often seek to generate increased [consumption](http://en.wikipedia.org/wiki/Consumption_(economics)) of their [products](http://en.wikipedia.org/wiki/Product_(business)) or [services](http://en.wikipedia.org/wiki/Service_(economics)) through "[branding](http://en.wikipedia.org/wiki/Brand)," which involves the repetition of an image or product name in an effort to associate certain qualities with the brand in the minds of [consumers](http://en.wikipedia.org/wiki/Consumer). [Non-commercial](http://en.wikipedia.org/wiki/Non-commercial) advertisers who spend money to advertise items other than a consumer product or service include political parties, interest groups, religious organizations and governmental agencies. [Non-profit organizations](http://en.wikipedia.org/wiki/Nonprofit_organizations) may rely on free modes of [persuasion](http://en.wikipedia.org/wiki/Persuasion), such as a [public service announcement](http://en.wikipedia.org/wiki/Public_service_announcement) (PSA).

Modern advertising developed with the rise of [mass production](http://en.wikipedia.org/wiki/Mass_production) in the late 19th and early 20th centuries.

## Brand

A **brand** is a "Name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers."[*Branding*](http://en.wikipedia.org/wiki/Livestock_branding) began as a way to tell one person's cattle from another by means of a [hot iron stamp](http://en.wikipedia.org/wiki/Branding_iron). A modern example of a brand is *Coca Cola* which belongs to the Coca-Cola Company.

**Marque**or **make** are often used to denote a brand of [motor vehicle](http://en.wikipedia.org/wiki/Motor_vehicle). A **concept brand** is a brand that is associated with an abstract concept, like [breast cancer awareness](http://en.wikipedia.org/wiki/Breast_cancer_awareness) or [environmentalism](http://en.wikipedia.org/wiki/Environmentalism), rather than a specific product, service, or business. A **commodity brand** is a brand associated with a [commodity](http://en.wikipedia.org/wiki/Commodity). [Got milk?](http://en.wikipedia.org/wiki/Got_milk%3F) is an example of a commodity brand.

### Brand awareness

Brand awareness refers to customers' ability to recall and recognize the brand under different conditions and link to the brand name, logo, jingles and so on to certain associations in memory. It consists of both brand recognition and brand recall. It helps the customers to understand to which product or service category the particular brand belongs and what products and services are sold under the brand name. It also ensures that customers know which of their needs are satisfied by the brand through its products (Keller). Brand awareness is of critical importance since customers will not consider your brand if they are not aware of it.[[13]](http://en.wikipedia.org/wiki/Brand#cite_note-12)

There are various levels of brand awareness that require different levels and combinations of brand recognition and recall. Top-of-Mind is the goal of most companies. **Top-of-Mind Awareness** occurs when your brand is what pops into a consumers mind when asked to name brands in a product category. For example, when someone is asked to name a type of facial tissue, the common answer is “Kleenex,” which is a top-of-mind brand. **Aided Awareness** occurs when a consumer is shown or reads a list of brands, and expresses familiarity with your brand only after they hear or see it as a type of memory aide. **Strategic Awareness** occurs when your brand is not only top-of-mind to consumers, but also has distinctive qualities that stick out to consumers as making it better than the other brands in your market. The distinctions that set your product apart from the competition is also known as the Unique Selling Point or USP.

### Brand elements

Brands typically are made up of various elements, such as:

* Name: The word or words used to identify a company, product, service, or concept.
* Logo: The visual trademark that identifies the brand.
* Tagline or Catchphrase: "The Quicker Picker Upper" is associated with Bounty paper towels. "Can you hear me now" is an important part of the Verizon brand.
* Graphics: The dynamic ribbon is a trademarked part of Coca-Cola's brand.
* Shapes: The distinctive shapes of the Coca-Cola bottle and of the Volkswagen Beetle are trademarked elements of those brands.
* Colours: Owens-Corning is the only brand of fibreglass insulation that can be pink.
* Sounds: A unique tune or set of notes can denote a brand. NBC's chimes are a famous example.
* Scents: The rose-jasmine-musk scent of Chanel No. 5 is trademarked.
* Tastes: Kentucky Fried Chicken has trademarked its special recipe of eleven herbs and spices for fried chicken.
* Movements: Lamborghini has trademarked the upward motion of its car doors.

### Global brand

A global brand is one which is perceived to reflect the same set of values around the world. Global brands transcend their origins and create strong enduring relationships with consumers across countries and cultures. They are brands sold in international markets. Examples of global brands include  [Facebook](http://en.wikipedia.org/wiki/Facebook),  [Apple](http://en.wikipedia.org/wiki/Apple_Inc.), [Pepsi](http://en.wikipedia.org/wiki/Pepsi), [McDonald's](http://en.wikipedia.org/wiki/McDonald%27s), [Mastercard](http://en.wikipedia.org/wiki/Mastercard), [Gap](http://en.wikipedia.org/wiki/Gap_(clothing_retailer)), [Sony](http://en.wikipedia.org/wiki/Sony) and [Nike](http://en.wikipedia.org/wiki/Nike,_Inc.). These brands are used to sell the same product across multiple markets and could be considered successful to the extent that the associated products are easily recognizable by the diverse set of consumers.

[[](http://en.wikipedia.org/wiki/File:Coca-Cola_logo.svg)](http://en.wikipedia.org/wiki/File:Coca-Cola_logo.svg)

[http://bits.wikimedia.org/static-1.20wmf3/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Coca-Cola_logo.svg)

The [Coca-Cola](http://en.wikipedia.org/wiki/Coca-Cola) logo is an example of a widely-recognized trademark and global brand.

# IX Management

**Management** is the act of getting people together to accomplish desired goals and [objectives](http://en.wikipedia.org/wiki/Objective_(goal)) using available resources efficiently and effectively. Management comprises [planning](http://en.wikipedia.org/wiki/Planning), [organizing](http://en.wikipedia.org/wiki/Organizing), [staffing](http://en.wikipedia.org/wiki/Human_resources), [leading](http://en.wikipedia.org/wiki/Leadership) or directing, and [controlling](http://en.wikipedia.org/wiki/Control_(management)) an [organization](http://en.wikipedia.org/wiki/Organization) (a group of one or more people or entities) or effort for the purpose of accomplishing a goal. [Resourcing](http://en.wikipedia.org/wiki/Resourcing) encompasses the deployment and manipulation of [human resources](http://en.wikipedia.org/wiki/Human_resources), [financial](http://en.wikipedia.org/wiki/Financial) resources, [technological](http://en.wikipedia.org/wiki/Technological) resources and [natural resources](http://en.wikipedia.org/wiki/Natural_resources).

Since organizations can be viewed as [systems](http://en.wikipedia.org/wiki/Systems), management can also be defined as human action, including design, to facilitate the production of useful outcomes from a system. This view opens the opportunity to 'manage' oneself, a pre-requisite to attempting to manage others.

## Topics

### Basic roles

* **Interpersonal**: roles that involve coordination and interaction with employees, networking.
* **Informational**: roles that involve handling, sharing, and analyzing information.
* **Decisional**: roles that require decision-making.

### Management skills

* **Political**: used to build a power base and establish connections.
* **Conceptual**: used to analyze complex situations.
* **Interpersonal**: used to communicate, motivate, mentor and delegate.
* **Diagnostic**: the ability to visualize most appropriate response to a situation .

### Formation of the business policy

* The mission of the business is the most obvious purpose—which may be, for example, to make soap.
* The vision of the business reflects its aspirations and specifies its intended direction or future destination.
* The objectives of the business refer to the ends or activity at which a certain task is aimed.
* The business's policy is a guide that stipulates rules, regulations and objectives, and may be used in the managers' decision-making. It must be flexible and easily interpreted and understood by all employees.
* The business's strategy refers to the coordinated plan of action that it is going to take, as well as the resources that it will use, to realize its vision and long-term objectives. It is a guideline to managers, stipulating how they ought to allocate and utilize the factors of production to the business's advantage. Initially, it could help the managers decide on what type of business they want to form.

#### Implementation of policies and strategies

* All policies and strategies must be discussed with all managerial personnel and staff.
* Managers must understand where and how they can implement their policies and strategies.
* A plan of action must be devised for each department.
* Policies and strategies must be reviewed regularly.
* Contingency plans must be devised in case the environment changes.
* Assessments of progress ought to be carried out regularly by top-level managers.
* A good environment and team spirit is required within the business.
* The missions, objectives, strengths and weaknesses of each department must be analyzed to determine their roles in achieving the business's mission.
* The forecasting method develops a reliable picture of the business's future environment.
* A planning unit must be created to ensure that all plans are consistent and that policies and strategies are aimed at achieving the same mission and objectives. All policies must be discussed with all managerial personnel and staff that is required in the execution of any departmental policy.
* Organizational change is strategically achieved through the implementation of the eight-step plan of action established by [John P. Kotter](http://en.wikipedia.org/wiki/John_Kotter): Increase urgency, form a coalition, get the vision right, communicate the buy-in, empower action, create short-term wins, don't let up, and make change stick.

#### Policies and strategies in the planning process

* They give mid- and lower-level managers a good idea of the future plans for each department in an organization.
* A framework is created whereby plans and decisions are made.
* Mid- and lower-level management may adapt their own plans to the business's strategic ones.

### Levels of management

Most organizations have three management levels: low-level, middle-level, and top-level managers. These managers are classified in a hierarchy of authority, and perform different tasks. In many organizations, the number of managers in every level resembles a pyramid. Each level is explained below in specifications of their different responsibilities and likely job titles.[[9]](http://en.wikipedia.org/wiki/Management#cite_note-8)

#### Top-level managers

Consists of [board of directors](http://en.wikipedia.org/wiki/Board_of_directors), president, vice-president, [CEOs](http://en.wikipedia.org/wiki/CEO), etc. They are responsible for controlling and overseeing the entire organization. They develop goals, strategic plans, company policies, and make decisions on the direction of the business. In addition, top-level managers play a significant role in the mobilization of outside resources and are accountable to the shareholders and general public.

According to Lawrence S. Kleiman, the following skills are needed at the top managerial level.

* Broadened understanding of how: competition, world economies, politics, and social trends effect organizational effectiveness.

#### Middle-level managers

Consist of general managers, branch managers and department managers. They are accountable to the top management for their department's function. They devote more time to organizational and directional functions. Their roles can be emphasized as executing organizational plans in conformance with the company's policies and the objectives of the top management, they define and discuss information and policies from top management to lower management, and most importantly they inspire and provide guidance to lower level managers towards better performance. Some of their functions are as follows:

* Designing and implementing effective group and intergroup work and information systems.
* Defining and monitoring group-level performance indicators.
* Diagnosing and resolving problems within and among work groups.
* Designing and implementing reward systems supporting cooperative behaviour.

#### Low-level managers

Consist of supervisors, section leads, foremen, etc. They focus on controlling and directing. They usually have the responsibility of assigning employees tasks, guiding and supervising employees on day-to-day activities, ensuring quality and quantity production, making recommendations, suggestions, and up channelling employee problems, etc. First-level managers are role models for employees that provide:

* Basic supervision.
* Motivation.
* Career planning.
* Performance feedback.
* Supervising the staffs.

## Operations management

**Operations management** is an area of [management](http://en.wikipedia.org/wiki/Management) concerned with overseeing, designing, controlling the process of production and redesigning [business operations](http://en.wikipedia.org/wiki/Business_operations) in the production of goods and/or services. It involves the responsibility of ensuring that business operations are [efficient](http://en.wikipedia.org/wiki/Efficiency) in terms of using as few resources as needed, and [effective](http://en.wikipedia.org/wiki/Effective) in terms of meeting customer requirements. It is concerned with managing the process that converts inputs (in the forms of materials, labor, and energy) into outputs (in the form of goods and/or services). The relationship of operations management to [senior management](http://en.wikipedia.org/wiki/Senior_management) in commercial contexts can be compared to the relationship of [line officers](http://en.wikipedia.org/wiki/Line_officer) to highest-level senior officers in [military science](http://en.wikipedia.org/wiki/Military_science). The highest-level officers shape the [strategy](http://en.wikipedia.org/wiki/Strategy) and revise it over time, while the line officers make [tactical](http://en.wikipedia.org/wiki/Military_tactics) decisions in support of carrying out the strategy. In business as in military affairs, the boundaries between levels are not always distinct; tactical information dynamically informs strategy, and individual people often move between roles over time.

According to the U.S. Department of Education, operations management is the field concerned with managing and directing the physical and/or technical functions of a firm or organization, particularly those relating to development, production, and manufacturing. Operations management programs typically include instruction in principles of general management, manufacturing and production systems, plant management, equipment maintenance management, production control, industrial labor relations and skilled trades supervision, strategic manufacturing policy, systems analysis, productivity analysis and cost control, and materials planning. Management, including operations management, is like [engineering](http://en.wikipedia.org/wiki/Engineering) in that it blends art with [applied science](http://en.wikipedia.org/wiki/Applied_science). People skills, creativity, rational analysis, and knowledge of technology are all required for success.

## Strategic management

**Strategic management** is a field that deals with the major intended and emergent initiatives taken by [general managers](http://en.wikipedia.org/wiki/General_manager) on behalf of owners, involving utilization of [resources](http://en.wikipedia.org/wiki/Factors_of_production), to enhance the performance of [ﬁrms](http://en.wikipedia.org/wiki/Business) in their external environments.[[1]](http://en.wikipedia.org/wiki/Strategic_management#cite_note-0) It entails specifying the [organization](http://en.wikipedia.org/wiki/Organization)'s [mission](http://en.wikipedia.org/wiki/Mission_statement), vision and objectives, developing policies and plans, often in terms of projects and programs, which are designed to achieve these objectives, and then allocating resources to implement the policies and plans, projects and programs. A [balanced scorecard](http://en.wikipedia.org/wiki/Balanced_scorecard) is often used to evaluate the overall performance of the [business](http://en.wikipedia.org/wiki/Business) and its progress towards objectives. Recent studies and leading management theorists have advocated that strategy needs to start with stakeholders expectations and use a modified balanced scorecard which includes all stakeholders.

Strategic management is a level of managerial activity under setting goals and over [Tactics](http://en.wikipedia.org/wiki/Tactic_(method)). Strategic management provides overall direction to the enterprise and is closely related to the field of [Organization Studies](http://en.wikipedia.org/wiki/Organization_Studies). In the field of business administration it is useful to talk about "strategic alignment" between the organization and its environment or "strategic consistency." According to Arieu (2007), "there is strategic consistency when the actions of an organization are consistent with the expectations of management, and these in turn are with the market and the context." Strategic management includes not only the management team but can also include the Board of Directors and other stakeholders of the organization. It depends on the organizational structure.

“Strategic management is an ongoing process that evaluates and controls the business and the industries in which the company is involved; assesses its competitors and sets goals and strategies to meet all existing and potential competitors; and then reassesses each strategy annually or quarterly [i.e. regularly] to determine how it has been implemented and whether it has succeeded or needs replacement by a new strategy to meet changed circumstances, new technology, new competitors, a new economic environment., or a new social, financial, or political environment.” Strategic Management can also be defined as "the identification of the purpose of the organization and the plans and actions to achieve the purpose. It is that set of managerial decisions and actions that determine the long term performance of a business enterprise. It involves formulating and implementing strategies that will help in aligning the organization and its environmental to achieve organizational goals."

## Concepts/approaches of strategic management

Strategic management can depend upon the size of an organization, and the proclivity to change of its business environment. These points are highlighted below:

* A global/transnational organization may employ a more structured strategic management model, due to its size, scope of operations, and need to encompass stakeholder views and requirements.
* An SME (Small and Medium Enterprise) may employ an entrepreneurial approach. This is due to its comparatively smaller size and scope of operations, as well as possessing fewer resources. An SME's CEO (or general top management) may simply outline a mission, and pursue all activities under that mission.
* Whittington (2001) highlighted four approaches to strategic management, utilising different factors that organisations may face. These are the Classical, Processual, Evolutionary and Systemic approaches. Each paradigm is suited to specific environmental factors, of which global firms have faced over the past 4/5 decades.
* Mintzberg has stated there are prescriptive (what should be) and descriptive (what is) schools, in the sense that the prescriptive schools are "one size fits all" approaches designed to work as best practice methods, and the descriptive schools merely describe how corporate strategy is devised in given contexts.

It can be said that there is no overriding strategic managerial method, and that a number of differing variables must be taken into account, relative to how a corporate strategic plan is outlined. It can also be said to be a subjective and highly contextual process.

## Strategy formation (Classical school)

The Classical School of strategic management is the most taught and deployed approach, of which most textbooks on the subject convey. The essential points of the approach are "where are we now?", "where do we want to be?" and "how do we get there?". It thus comprises an environmental analysis, a choice of available options, and determining a path for action and implementation.

The initial task in strategic management is typically the compilation and dissemination of a mission statement. This document outlines, in essence, the raison d'etre of an organization. Additionally, it specifies the scope of activities an organization wishes to undertake, coupled with the markets a firm wishes to serve.

Following the devising of a mission statement, a firm would then undertake an environmental scanning within the purview of the statement.

Strategic formation is a combination of three main processes which are as follows:

* Performing a situation analysis, self-evaluation and competitor analysis: both internal and external; both micro-environmental and macro-environmental.
* Concurrent with this assessment, objectives are set. These objectives should be parallel to a time-line; some are in the short-term and others on the long-term. This involves crafting vision statements (long term view of a possible future), mission statements (the role that the organization gives itself in society), overall corporate objectives (both financial and strategic), strategic business unit objectives (both financial and strategic), and tactical objectives.

### Strategy evaluation and choice

An environmental scan will highlight all pertinent aspects that affect an organization, whether external or sector/industry-based. Such an occurrence will also uncover areas to capitalise on, in addition to areas in which expansion may be unwise.

These options, once identified, have to be vetted and screened by an organization. In addition to ascertaining the suitability, feasibility and acceptability of an option, the actual modes of progress have to be determined. These pertain to:

#### The basis of competition

The basis of competition is the competitive advantage used or established by the strategy. This advantage may derive from how an organization produces its products, how it acts within a market relative to its competitors, or other aspects of the business. Specific approaches may include:

* Differentiation, in which a multitude of market segments are served on a mass scale. An example will include the array of products produced by Unilever, or Procter and Gamble, as both forge many of the world’s noted consumer brands serving a variety of market segments.
* Cost-based, which often concerns economy pricing. An example would be dollar stores in the United States.
* Market segmentation (or niche), in which products are tailored for the unique needs of a niche market, as opposed to a mass market. An example is Aston Martin cars.

#### Mode of action

* Measuring the effectiveness of the organizational strategy, it's extremely important to conduct a [SWOT analysis](http://en.wikipedia.org/wiki/SWOT_analysis) to figure out the internal strengths and weaknesses, and external opportunities and threats of the entity in business. This may require taking certain precautionary measures or even changing the entire strategy.

In corporate strategy, Johnson, Scholes and Whittington present a model in which strategic options are evaluated against three key success criteria:

* Suitability; would it work?
* Feasibility; can it be made to work?
* Acceptability; will they work it?

#### Suitability

Suitability deals with the overall rationale of the strategy. The key point to consider is whether the strategy would address the key strategic issues underlined by the organisation's strategic position.

* Does it make economic sense?
* Would the organization obtain [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale) or [economies of scope](http://en.wikipedia.org/wiki/Economies_of_scope)?
* Would it be suitable in terms of environment and capabilities?

Tools that can be used to evaluate suitability include:

* Ranking strategic options
* [Decision trees](http://en.wikipedia.org/wiki/Decision_tree)

#### Feasibility

Feasibility is concerned with whether the resources required to implement the strategy are available, can be developed or obtained. Resources include **funding**, **people**, **time**, and **information**. or cash flow in the market

Tools that can be used to evaluate feasibility include:

* [cash flow](http://en.wikipedia.org/wiki/Cash_flow) analysis and [forecasting](http://en.wikipedia.org/wiki/Forecasting)
* [break-even](http://en.wikipedia.org/wiki/Break-even) analysis
* resource deployment analysis

#### Acceptability

Acceptability is concerned with the expectations of the identified stakeholders (mainly shareholders, employees and customers) with the expected performance outcomes, which can be return, risk and stakeholder/stakeholders reactions.

* **Return** deals with the benefits expected by the stakeholders (financial and non-financial). For example, shareholders would expect the increase of their wealth, employees would expect improvement in their careers and customers would expect better value for money.
* **Risk** deals with the probability and consequences of failure of a strategy (financial and non-financial).
* **Stakeholder reactions** deal with anticipating the likely reaction of stakeholders. Shareholders could oppose the issuing of new shares, employees and unions could oppose outsourcing for fear of losing their jobs, customers could have concerns over a merger with regards to quality and support.

Tools that can be used to evaluate acceptability include:

* [what-if analysis](http://en.wikipedia.org/wiki/What-if_analysis)
* [stakeholder](http://en.wikipedia.org/wiki/Stakeholder_(corporate)) mapping

#### The direction of action

Strategic options may span a number of options, including:

* Growth-based (inspired by Igor Ansoff's matrix – market development, product development, market penetration, diversification)
* Consolidation
* Divestment
* Harvesting

The exact option depends on the given resources of the firm, in addition to the nature of products' performance in given industries. A generally well-performing organisation may seek to harvest (,i.e. let a product die a natural death in the market) a product, if via portfolio analysis it was performing poorly comparative to others in the market.

Additionally, the exact means of implementing a strategy needs to be considered. These points range from:

* Strategic alliances
* Capital Expenditures (CAPEX)
* Internal development (,i.e. utilising one's own strategic capability in a given course of action)
* M&A (Mergers and Acquisitions)

The chosen option in this context is dependent on the strategic capabilities of a firm. A company may opt for an acquisition (actually buying and absorbing a smaller firm), if it meant speedy entry into a market or lack of time in internal development. A strategic alliance (such as a network, consortium or joint venture) can leverage on mutual skills between companies. Some countries, such as India and China, specifically state that FDI in their countries should be executed via a strategic alliance arrangement.

### Strategic implementation and control

Once a strategy has been identified, it must then be put into practice. The implementation of strategy is of great importance. Conducting a corporate strategy is worthless as long as it is not implemented correctly by each department of the organization This may involve organising, resourcing and utilising change management procedures:

#### Organizing

Organizing relates to how an organizational design of a company can fit or align with a chosen strategy. This concerns the nature of reporting relationships, spans of control, and any strategic business units (SBUs) that require to be formed. Typically, an SBU will be created (which often has some degree of autonomous decision-making) if it exists in a market with unique conditions, or has/requires unique strategic capabilities (,i.e. the skills needed for the running and competition of the SBU are different).

#### Resourcing

Resourcing is literally the resources required to put the strategy into practice, ranging from human resources, to capital equipment, and to ICT-based implements.

#### Change management

In the process of implementing strategic plans, an organization must be wary of forces that may legitimately seek to obstruct such changes. It is important then that effectual change management practices are instituted. These encompass:

* The appointment of a change agent, as an individual who would champion the changes and seek to reassure and allay any fears arising.
* Ascertaining the causes of the resistance to organizational change (whether from employees, perceived loss of job security, etc.)
* Via change agency, slowly limiting the negative effects that a change may uncover.

## Benchmarking

**Benchmarking** is the process of comparing one's business processes and [performance metrics](http://en.wikipedia.org/wiki/Performance_metric) to industry bests or [best practices](http://en.wikipedia.org/wiki/Best_practice) from other industries. Dimensions typically measured are quality, time and cost. In the process of benchmarking, management identifies the best firms in their industry, or in another industry where similar processes exist, and compare the results and processes of those studied (the "targets") to one's own results and processes. In this way, they learn how well the targets perform and, more importantly, the business processes that explain why these firms are successful.

The term *benchmarking* was first used by [cobblers](http://en.wikipedia.org/wiki/Shoemaking) to measure people's feet for shoes. They would place someone's foot on a "bench" and mark it out to make the pattern for the shoes. Benchmarking is used to measure performance using a specific [indicator](http://en.wikipedia.org/wiki/Performance_indicator) (cost per unit of measure, productivity per unit of measure, cycle time of x per unit of measure or defects per unit of measure) resulting in a metric of performance that is then compared to others.

Also referred to as "best practice benchmarking" or "process benchmarking", this process is used in management and particularly [strategic management](http://en.wikipedia.org/wiki/Strategic_management), in which organizations evaluate various aspects of their processes in relation to best practice companies' processes, usually within a peer group defined for the purposes of comparison. This then allows organizations to develop plans on how to make improvements or adapt specific best practices, usually with the aim of increasing some aspect of performance. Benchmarking may be a one-off event, but is often treated as a continuous process in which organizations continually seek to improve their practices.

## Benefits and use

In 2008, a comprehensive survey [[1]](http://en.wikipedia.org/wiki/Benchmarking#cite_note-0) on benchmarking was commissioned by The Global Benchmarking Network, a network of benchmarking centers representing 22 countries. Over 450 organizations responded from over 40 countries. The results showed that:

1. Mission and Vision Statements and Customer (Client) Surveys are the most used (by 77% of organizations of 20 improvement tools, followed by [SWOT analysis](http://en.wikipedia.org/wiki/SWOT_analysis) (72%), and Informal Benchmarking (68%). [Performance Benchmarking](http://en.wikipedia.org/w/index.php?title=Performance_Benchmarking&action=edit&redlink=1) was used by 49% and Best Practice Benchmarking by 39%.
2. The tools that are likely to increase in popularity the most over the next three years are Performance Benchmarking, Informal Benchmarking, SWOT, and Best Practice Benchmarking. Over 60% of organizations that are not currently using these tools indicated they are likely to use them in the next three years.

Core competency

A **core competency** is a concept in management theory originally advocated by CK Prahalad, and Gary Hamel, two business book writers. In their view a core competency is a specific factor that a [business](http://en.wikipedia.org/wiki/Business) sees as being central to the way it, or its [employees](http://en.wikipedia.org/wiki/Employees), works. It fulfills three key criteria:

1. It is not easy for competitors to imitate.
2. It can be re-used widely for many products and markets.
3. It must contribute to the end consumer's experienced benefits.

A core competency can take various forms, including technical/subject matter know-how, a reliable process and/or close relationships with customers and suppliers.[[1]](http://en.wikipedia.org/wiki/Core_competence#cite_note-0) It may also include product development or culture, such as employee dedication, best Human Resource Management (HRM), good market coverage etc.

Core competencies are particular strengths relative to other organizations in the industry which provide the fundamental basis for the provision of added value. Core competencies are the collective learning in organizations, and involve how to coordinate diverse production skills and integrate multiple streams of technologies. It is communication, an involvement and a deep commitment to working across organizational boundaries. Few companies are likely to build world leadership in more than five or six fundamental competencies.

For an example of core competencies, when studying Walt Disney World - Parks and Resorts, there are three main core competencies:

* Animatronics and Show Design
* [Storytelling](http://en.wikipedia.org/wiki/Storytelling), Story Creation and Themed Atmospheric Attractions
* Efficient operation of theme parks

The [value chain](http://en.wikipedia.org/wiki/Value_chain) is a systematic approach to examining the development of competitive advantage. It was created by [M. E. Porter](http://en.wikipedia.org/wiki/Michael_Porter) in his book, *Competitive Advantage* (1980). The chain consists of a series of activities that create and build value. They culminate in the total value delivered by an organization. The 'margin' depicted in the diagram is the same as added value. The organization is split into 'primary activities' and 'support activities'.

Core Competence

A core competence is the result of a specific set of skills or production techniques that deliver value to the customer. Such competences enable an organization to access a wide variety of markets. Executives should estimate the future challenges and opportunities of the business in order to stay on top of the game in varying situations.

In 1990 with their article titled "The Core Competence of the Corporation", Prahalad and Hamel illustrated that core competencies lead to the development of core products which further can be used to build many products for end users. Core competencies are developed through the process of continuous improvements over the period of time. To succeed in an emerging global market it is more important and required to build core competencies rather than [vertical integration](http://en.wikipedia.org/wiki/Vertical_integration). [NEC](http://en.wikipedia.org/wiki/NEC) utilized its portfolio of core competencies to dominate the semiconductor, telecommunications and consumer electronics market. It is important to identify core competencies because it is difficult to retain those competencies in a price war and cost cutting environment. The author used the example of how to integrate core competences using strategic architecture in view of changing market requirements and evolving technologies. Management must realize that stakeholders to core competences are an asset which can be utilized to integrate and build the competencies. Competence building is an outcome of strategic architecture which must be enforced by top management in order to exploit its full capacity.

In *Competing for the Future*, the authors Prahalad and Hamel show how executives can develop the industry foresight necessary to adapt to industry changes, discover ways of controlling resources that will enable the company to attain goals despite any constraints. Executives should develop a point of view on which core competencies can be built for the future to revitalize the process of new business creation. The key to future industry leadership is to develop an independent point of view about tomorrow's opportunities and build capabilities that exploit them.

In order to be competitive an organization needs tangible resources but intangible resources like core competences are difficult and challenging to achieve. It is even critical to manage and enhance the competences with reference to industry changes and their future. For example, Microsoft has expertise in many IT based innovations where for a variety of reasons it is difficult for competitors to replicate Microsoft's core competences.

In a race to achieve cost cutting, quality and productivity most of the executives do not spend their time to develop a corporate view of the future because this exercise demands high intellectual energy and commitment. The difficult questions may challenge their own ability to view the future opportunities but an attempt to find their answers will lead towards organizational benefits.

## Shareholder

A **shareholder** or **stockholder** is an [individual](http://en.wikipedia.org/wiki/Individual) or institution (including a [corporation](http://en.wikipedia.org/wiki/Corporation)) that legally owns any part of a [share](http://en.wikipedia.org/wiki/Share_(finance)) of [stock](http://en.wikipedia.org/wiki/Stock) in a public or private corporation. Shareholders own the stock, but not the corporation itself.

Stockholders are granted special privileges depending on the class of stock. These rights may include:

* The right to sell their shares,
* The right to vote on the directors nominated by the board,
* The right to nominate directors (although this is very difficult in practice because of minority protections) and propose [shareholder resolutions](http://en.wikipedia.org/wiki/Shareholder_resolutions),
* The right to dividends if they are declared,
* The right to purchase new shares issued by the company, and
* The rights to what assets remain after a [liquidation](http://en.wikipedia.org/wiki/Liquidation).

Stockholders or shareholders are considered by some to be a [subset](http://en.wikipedia.org/wiki/Subset) of [stakeholders](http://en.wikipedia.org/wiki/Stakeholder_(corporate)), which may include anyone who has a direct or indirect interest in the [business entity](http://en.wikipedia.org/wiki/Business_entity). For example, labor, suppliers, customers, the community, etc., are typically considered stakeholders because they contribute value and/or are impacted by the corporation.

|  |  |
| --- | --- |
| **Stakeholders** | **Examples of interests** |
| **Government** | Taxation, [VAT](http://en.wikipedia.org/wiki/VAT), [legislation](http://en.wikipedia.org/wiki/Legislation), low unemployment, truthful reporting. |
| **Employees** | Rates of pay, [job security](http://en.wikipedia.org/wiki/Job_security), compensation, respect, truthful communication. |
| **Customers** | Value, quality, customer care, ethical products. |
| **Suppliers** | Providers of products and services used in the end product for the customer, equitable business opportunities. |
| **Creditors** | Credit score, new contracts, liquidity. |
| **Community** | Jobs, involvement, environmental protection, shares, truthful communication. |
| **Trade Unions** | Quality, Staff protection, jobs. |
| **Owner(s)** | Have interest of the success of his/her business. |

Shareholders in the primary market who buy IPOs provide capital to corporations; however, the vast majorities of shareholders are in the secondary market and provide no capital directly to the corporation.

Therefore, contrary to popular opinion, shareholders of American public corporations are not the (1) owners of the corporation, (2) the claimants of the profit, nor (3) investors, as in the contributors of capital

## Stakeholder (corporate)

A corporate **stakeholder** is a party that can affect or be affected by the actions of the business as a whole. The stakeholder concept was first used in a 1963 internal memorandum at the [Stanford Research Institute](http://en.wikipedia.org/wiki/Stanford_Research_Institute). It defined stakeholders as "those groups without whose support the organization would cease to exist."[[1]](http://en.wikipedia.org/wiki/Stakeholder_(corporate)#cite_note-0) The theory was later developed and championed by [R. Edward Freeman](http://en.wikipedia.org/wiki/R._Edward_Freeman) in the 1980s. Since then it has gained wide acceptance in business practice and in theorizing relating to [strategic management](http://en.wikipedia.org/wiki/Strategic_management), [corporate governance](http://en.wikipedia.org/wiki/Corporate_governance), [business purpose](http://en.wikipedia.org/w/index.php?title=Business_purpose&action=edit&redlink=1) and [corporate social responsibility](http://en.wikipedia.org/wiki/Corporate_social_responsibility) (CSR).

### Types of stakeholders

* People who will be affected by an endeavor and can influence it but who are not directly involved with doing the work.
* In the [private sector](http://en.wikipedia.org/wiki/Private_sector), people who are (or might be) affected by any action taken by an organization or group. Examples are parents, children, customers, owners, employees, associates, partners, contractors, and suppliers, people that are related or located nearby. Any group or individual who can affect or who is affected by achievement of a group's objectives.
* An individual or group with an interest in a group's or an organization's success in delivering intended results and in maintaining the viability of the group or the organization's product and/or service. Stakeholders influence programs, products, and services.
* Any organization, governmental entity, or individual that has a stake in or may be impacted by a given approach to environmental regulation, pollution prevention, energy conservation, etc.
* A participant in a community mobilization effort, representing a particular segment of society. School board members, environmental organizations, elected officials, chamber of commerce representatives, neighborhood advisory council members, and religious leaders are all examples of local stakeholders.

**Market (or Primary) Stakeholders** - usually internal stakeholders, are those that engage in economic transactions with the business. (For example stockholders, customers, suppliers, creditors, and employees)

**Non-Market (or Secondary) Stakeholders** - usually external stakeholders, are those who - although they do not engage in direct economic exchange with the business - are affected by or can affect its actions. (For example the general public, communities, activist groups, business support groups, and the media)

### Company stakeholder mapping

A narrow mapping of a company's stakeholders might identify the following stakeholders:

* [Employees](http://en.wikipedia.org/wiki/Employees)
* [Communities](http://en.wikipedia.org/wiki/Community)
* [Shareholders](http://en.wikipedia.org/wiki/Shareholders)
* [Creditors](http://en.wikipedia.org/wiki/Creditors)
* [Investors](http://en.wikipedia.org/wiki/Investors)
* [Government](http://en.wikipedia.org/wiki/Government)
* [Customers](http://en.wikipedia.org/wiki/Customers)

A broader mapping of a company's stakeholders may also include:

* [Suppliers](http://en.wikipedia.org/wiki/Distributor_(business))
* [Labor unions](http://en.wikipedia.org/wiki/Labor_union)
* Government regulatory agencies
* Government legislative bodies
* Government tax-collecting agencies
* [Industry trade groups](http://en.wikipedia.org/wiki/Industry_trade_group)
* [Professional associations](http://en.wikipedia.org/wiki/Professional_association)
* [NGOs](http://en.wikipedia.org/wiki/NGO) and other [advocacy groups](http://en.wikipedia.org/wiki/Advocacy_group)
* Prospective employees
* Prospective customers
* [Local communities](http://en.wikipedia.org/wiki/Local_communities)
* National communities
* Public at Large (Global Community)
* [Competitors](http://en.wikipedia.org/wiki/Competitors)
* [Schools](http://en.wikipedia.org/wiki/School)
* Future generations
* Analysts and Media
* Alumni (Ex-employees)
* Research centers
* Each Person

### In management

In the last decades of the 20th century, the word "stakeholder" has become more commonly used to mean a person or organization that has a legitimate interest in a project or entity. In discussing the decision-making process for institutions—including large business [corporations](http://en.wikipedia.org/wiki/Corporation), [government agencies](http://en.wikipedia.org/wiki/Government_agency), and [non-profit organizations](http://en.wikipedia.org/wiki/Non-profit_organization) -- the concept has been broadened to include everyone with an interest (or "stake") in what the entity does. This includes not only its vendors, [employees](http://en.wikipedia.org/wiki/Employment), and[customers](http://en.wikipedia.org/wiki/Customer), but even members of a community where its offices or factory may affect the local economy or environment. In this context, "stakeholder" includes not only the directors or trustees on its governing board (who are stakeholders in the traditional sense of the word) but also all persons who "paid in" the figurative stake and the persons to whom it may be "paid out" (in the sense of a "payoff" in [game theory](http://en.wikipedia.org/wiki/Game_theory), meaning the outcome of the transaction).

**Example**

* For example, in the case of a professional landlord undertaking the refurbishment of some rented housing that is occupied while the work is being carried out, key stakeholders would be the residents, neighbors (for whom the work is a nuisance), and the tenancy management team and housing maintenance team employed by the landlord. Other stakeholders would be funders and the design and construction team.

The holders of each separate kind of interest in the entity's affairs are called a *constituency,* so there may be a constituency of [stockholders](http://en.wikipedia.org/wiki/Shareholder), a constituency of adjoining property owners, a constituency of [banks](http://en.wikipedia.org/wiki/Bank) the entity owes money to, and so on. In that usage, "constituent" is a synonym for "stakeholder."

## Stock trader

[](http://en.wikipedia.org/wiki/File:NY_stock_exchange_traders_floor_LC-U9-10548-6.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:NY_stock_exchange_traders_floor_LC-U9-10548-6.jpg)Historical photo of stock traders and [stock brokers](http://en.wikipedia.org/wiki/Stock_brokers) in the [trading floor](http://en.wikipedia.org/wiki/Trading_floor) of the [New York Stock Exchange](http://en.wikipedia.org/wiki/New_York_Stock_Exchange) (1963).

A **stock trader** or a **stock investor** is an [individual](http://en.wikipedia.org/wiki/Individual) or [firm](http://en.wikipedia.org/wiki/Company_(law)) who [buys and sells](http://en.wikipedia.org/wiki/Trade) [stocks](http://en.wikipedia.org/wiki/Stock) in the [financial markets](http://en.wikipedia.org/wiki/Financial_markets). Many stock traders will trade [bonds](http://en.wikipedia.org/wiki/Bond_(finance)) (and possibly other [financial assets](http://en.wikipedia.org/wiki/Financial_asset)) as well. Trading stocks is a risky and complex occupation because the direction of the markets are generally unpredictable and lack transparency, also [financial regulators](http://en.wikipedia.org/wiki/Financial_regulation) are sometimes unable to adequately detect, prevent and remediate irregularities committed by malicious listed companies or other [financial market participants](http://en.wikipedia.org/wiki/Financial_market_participants). In addition, the financial markets are usually subjected to [speculation](http://en.wikipedia.org/wiki/Speculation).

## Stock traders and stock Investors

[](http://en.wikipedia.org/wiki/File:Deutsche-boerse-parkett-ffm001.jpg)

[http://bits.wikimedia.org/static-1.20wmf4/skins/common/images/magnify-clip.png](http://en.wikipedia.org/wiki/File:Deutsche-boerse-parkett-ffm001.jpg)

A view of a computerized [trading floor](http://en.wikipedia.org/wiki/Trading_floor) at the [Frankfurt Stock Exchange](http://en.wikipedia.org/wiki/Frankfurt_Stock_Exchange).

Stock traders are also known as *Stock Speculators*, if trading in that capacity. Individuals or firms trading equity ([stock](http://en.wikipedia.org/wiki/Stock)) on the [stock markets](http://en.wikipedia.org/wiki/Stock_market) as their principal capacity are often called stock [traders](http://en.wikipedia.org/wiki/Trader_(finance)). Stock traders usually try to profit from short-term price volatility with trades lasting anywhere from several seconds to several weeks.

The stock trader is usually a [professional](http://en.wikipedia.org/wiki/Professional). Persons can call themselves full or part-time stock traders/investors while maintaining other professions. When a stock trader/investor has clients, and acts as a money manager or adviser with the intention of adding value to their clients finances, he is also called a [financial advisor](http://en.wikipedia.org/wiki/Financial_advisor) or manager. In this case, the financial manager could be an independent professional or a large bank corporation employee. This may include managers dealing with [investment funds](http://en.wikipedia.org/wiki/Investment_fund), [hedge funds](http://en.wikipedia.org/wiki/Hedge_fund), [mutual funds](http://en.wikipedia.org/wiki/Mutual_funds), and[pension funds](http://en.wikipedia.org/wiki/Pension_fund), or other professionals in [venture capital](http://en.wikipedia.org/wiki/Venture_capital), [equity investment](http://en.wikipedia.org/wiki/Equity_investment), [fund management](http://en.wikipedia.org/wiki/Fund_management), and [wealth management](http://en.wikipedia.org/wiki/Wealth_management). These wealthy and powerful organized investors, are sometimes referred to as [institutional investors](http://en.wikipedia.org/wiki/Institutional_investors). Several different types of stock trading strategies or approaches exist including [day trading](http://en.wikipedia.org/wiki/Day_trading), [trend following](http://en.wikipedia.org/wiki/Trend_following), [market making](http://en.wikipedia.org/wiki/Market_maker), [scalping (trading)](http://en.wikipedia.org/wiki/Scalping_(trading)),[momentum trading](http://en.wikipedia.org/wiki/Momentum_trading), [trading the news](http://en.wikipedia.org/wiki/Trading_the_news), and [arbitrage](http://en.wikipedia.org/wiki/Arbitrage).

On the other hand, stock investors are firms or individuals who purchase stocks with the intention of holding them for an extended period of time, usually several months to years, for passive income objectives such as dividend accumulation. They rely primarily on [fundamental analysis](http://en.wikipedia.org/wiki/Fundamental_analysis) for their investment decisions and fully recognize stock shares as part-ownership in the company. Many investors believe in the [buy and hold](http://en.wikipedia.org/wiki/Buy_and_hold) strategy, which as the name suggests, implies that investors will buy stock ownership in a corporation and hold onto those stocks for the very long term, generally measured in years. This strategy was made popular in the equity bull market of the 1980s and 90s where buy-and-hold investors rode out short-term market declines and continued to hold as the market returned to its previous highs and beyond. However, during the 2001-2003 equity bear market, the buy-and-hold strategy lost some followers as broader market indexes like the [NASDAQ](http://en.wikipedia.org/wiki/NASDAQ) saw their values decline by over 60%.

## Entrepreneurship

**Entrepreneurship** is the act of being an [entrepreneur](http://en.wikipedia.org/wiki/Entrepreneur) or "*one who undertakes*[*innovations*](http://en.wikipedia.org/wiki/Innovations)*, finance and business acumen in an effort to transform innovations into economic goods*". This may result in new [organizations](http://en.wikipedia.org/wiki/Organization) or may be part of revitalizing mature [organizations](http://en.wikipedia.org/wiki/Organization) in response to a perceived opportunity. The most obvious form of entrepreneurship is that of starting new [businesses](http://en.wikipedia.org/wiki/Business) (referred as [Startup Company](http://en.wikipedia.org/wiki/Startup_Company)); however, in recent years, the term has been extended to include social and political forms of entrepreneurial activity. When entrepreneurship is describing activities within a firm or large organization it is referred to as intra-preneurship and may include corporate venturing, when large entities spin-off organizations.[[1]](http://en.wikipedia.org/wiki/Entrepreneurship#cite_note-0)

According to Paul Reynolds, entrepreneurship scholar and creator of the [Global Entrepreneurship Monitor](http://en.wikipedia.org/wiki/Global_Entrepreneurship_Monitor), "by the time they reach their retirement years, half of all working men in the United States probably have a period of self-employment of one or more years; one in four may have engaged in self-employment for six or more years. Participating in a new business creation is a common activity among U.S. workers over the course of their careers." [[2]](http://en.wikipedia.org/wiki/Entrepreneurship#cite_note-1) And in recent years has been documented by scholars such as [David Audretsch](http://en.wikipedia.org/wiki/David_Audretsch) to be a major driver of economic growth in both the United States and Western Europe. "As well, entrepreneurship may be defined as the pursuit of opportunity without regard to resources currently controlled (Stevenson, 1983)"

Entrepreneurial activities are substantially different depending on the type of organization and creativity involved. Entrepreneurship ranges in scale from solo projects (even involving the entrepreneur only part-time) to major undertakings creating many job opportunities. Many "high value" entrepreneurial ventures seek [venture capital](http://en.wikipedia.org/wiki/Venture_capital) or [angel funding](http://en.wikipedia.org/wiki/Angel_investors) ([seed money](http://en.wikipedia.org/wiki/Seed_money)) in order to raise [capital](http://en.wikipedia.org/wiki/Capital_(economics)) to build the business. Angel investors generally seek annualized returns of 20-30% and more, as well as extensive involvement in the business.[[4]](http://en.wikipedia.org/wiki/Entrepreneurship#cite_note-3) Many kinds of organizations now exist to support would-be entrepreneurs including specialized government agencies, [business incubators](http://en.wikipedia.org/wiki/Business_incubator), [science parks](http://en.wikipedia.org/wiki/Science_park), and some [NGOs](http://en.wikipedia.org/wiki/Non-governmental_organization). In more recent times, the term entrepreneurship has been extended to include elements not related necessarily to business formation activity such as conceptualizations of entrepreneurship as a specific [mindset](http://en.wikipedia.org/wiki/Mindset) (see also [entrepreneurial mindset](http://en.wikipedia.org/wiki/Entrepreneurial_mindset)) resulting in entrepreneurial initiatives e.g. in the form of [social entrepreneurship](http://en.wikipedia.org/wiki/Social_entrepreneurship), [political entrepreneurship](http://en.wikipedia.org/wiki/Political_entrepreneur), or [knowledge entrepreneurship](http://en.wikipedia.org/wiki/Knowledge_entrepreneurship) have emerged.

## Characteristics of an entrepreneur

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[Entrepreneurs](http://en.wikipedia.org/wiki/Entrepreneur) have many of the same character traits as [leaders](http://en.wikipedia.org/wiki/Leadership), similar to the early [great man theories](http://en.wikipedia.org/wiki/Great_man_theory) of leadership; however trait-based theories of entrepreneurship are increasingly being called into question. Entrepreneurs are often contrasted with managers and administrators who are said to be more methodical and less prone to risk-taking. Such person-centric models of entrepreneurship have shown to be of questionable validity, not least as many real-life entrepreneurs operate in teams rather than as single individuals. Still, a vast literature studying the entrepreneurial personality found that certain traits seem to be associated with entrepreneurs:

* **David McClelland** - primarily motivated by an overwhelming need for achievement and strong urge to build.
* **Collins and Moore** - tough, pragmatic people driven by needs of independence and achievement. They seldom are willing to submit to authority.
* **Bird** - mercurial, that is, prone to insights, brainstorms, deceptions, ingeniousness and resourcefulness. they are cunning, opportunistic, creative, and unsentimental.
* **Cooper, Woo, & Dunkelberg** - argue that entrepreneurs exhibit extreme optimism in their decision-making processes.
* **Busenitz and Barney** - prone to overconfidence and over generalizations.
* **Cole** - found there are four types of entrepreneur: the innovator, the calculating inventor, the over-optimistic promoter, and the organization builder. These types are not related to the personality but to the type of opportunity the entrepreneur faces.
* **John Howkins** - focused specifically on [creative entrepreneurship](http://en.wikipedia.org/wiki/Creative_entrepreneurship). He found that entrepreneurs in the creative industries needed a specific set of traits including the ability to prioritize ideas over data, to be nomadic and to learn endlessly.

## Concept

It has assumed super importance for accelerating economic growth both in developed and developing countries. It promotes capital formation and creates wealth in country. It is hope and dreams of millions of individuals around the world. It reduces unemployment and poverty and it is a pathway to prosper. Entrepreneurship is the process of exploring the opportunities in the market place and arranging resources required to exploit these opportunities for long term gain. It is the process of planning, organizing, opportunities and assuming. Thus it is a risk of business enterprise. It may be distinguished as an ability to take risk independently to make utmost earnings in the market. It is a creative and innovative skill and adapting response to environment.

## Promotion

Given entrepreneurship's potential to support economic growth, it is the policy goal of many governments to develop a culture of entrepreneurial thinking. This can be done in a number of ways: by integrating entrepreneurship into education systems, legislating to encourage risk-taking, and national campaigns. An example of the latter is the United Kingdom's Enterprise Week, which launched in 2004 which is one of the essential part of organization.

Outside of the political world, research has been conducted on the presence of entrepreneurial theories in doctoral economics programs. Dan Johansson, fellow at the Ratio Institute in Sweden, finds such content to be sparse. He fears this will dilute doctoral programs and fail to train young economists to analyze problems in a relevant way.

Many of these initiatives have been brought together under the umbrella of [Global Entrepreneurship Week](http://en.wikipedia.org/wiki/Global_Entrepreneurship_Week), a worldwide celebration and promotion of youth entrepreneurship, which started in 2008.

## Entrepreneur

An **entrepreneur** is an enterprising individual who builds capital through risk and/or initiative.[[1]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-0)[[note 1]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-1) The term was originally a [loanword](http://en.wikipedia.org/wiki/Loanword) from [French](http://en.wikipedia.org/wiki/French_language) and was first defined by the Irish-French [economist](http://en.wikipedia.org/wiki/Economist) [Richard Cantillon](http://en.wikipedia.org/wiki/Richard_Cantillon). Entrepreneur in [English](http://en.wikipedia.org/wiki/English_language) is a term applied to a person who is willing to help launch a new venture or enterprise and accept full responsibility for the outcome. [Jean-Baptiste Say](http://en.wikipedia.org/wiki/Jean-Baptiste_Say), a French economist, is believed to have coined the word "entrepreneur" in the 19th century - he defined an entrepreneur as "one who undertakes an enterprise, especially a contractor, acting as intermediatory between capital and labor".

## Leadership attributes

The entrepreneur leads the firm or organization and also demonstrates leadership qualities by selecting managerial staff. Management skill and strong team building abilities are essential leadership attributes for successful entrepreneurs. Scholar [Robert. B. Reich](http://en.wikipedia.org/wiki/Robert_Reich) considers [leadership](http://en.wikipedia.org/wiki/Leadership), management ability, and [team-building](http://en.wikipedia.org/wiki/Team-building) as essential qualities of an entrepreneur. This concept has its origins in the work of Richard Cantillon in his *Essai sur la Nature du Commerce en* (1755) and Jean-Baptiste Say in his *Treatise on Political Economy.*

Entrepreneurs emerge from the population on demand, and become leaders because they perceive opportunities available and are well-positioned to take advantage of them. An entrepreneur may perceive that they are among the few to recognize or be able to solve a problem. [Joseph Schumpeter](http://en.wikipedia.org/wiki/Joseph_Schumpeter) saw the entrepreneur as innovators and popularized the uses of the phrase [creative destruction](http://en.wikipedia.org/wiki/Creative_destruction) to describe his view of the role of entrepreneurs in changing business norms. Creative destruction encompasses changes entrepreneurial activity makes every time a new process, product or company enters the markets.

## Influences, personality traits, and characteristics

The most significant influence on an individual's decision to become an entrepreneur is workplace peers and the social composition of the workplace. The ability of entrepreneurs to innovate relates to innate traits such as extroversion and a proclivity for risk-taking. According to Schumpeter (1934), the capabilities of innovating, introducing new technologies, increasing efficiency and productivity, or generating new products or services, are characteristics of entrepreneurs. Entrepreneurs are catalysts for economic change. Research has found entrepreneurs to be highly creative with a tendency to imagine new solutions by finding opportunities for profit or reward. An Examination of the Impact of Selected Personality Traits on the Innovat.

There is a complexity and lack of cohesion between research studies that explore the characteristics and personality traits of, and influences on, the entrepreneur. Most studies, however, agree that there are certain entrepreneurial traits and environmental influences that tend to be consistent. Although certain entrepreneurial traits are required, entrepreneurial behaviors are dynamic and influenced by environmental factors. Shane and Venkataraman (2000) argue the entrepreneur is solely concerned with opportunity recognition and exploitation; although, the opportunity that is recognized depends on the type of entrepreneur which Ucbasaran et al. (2001) argue there are many different types dependent on their business and personal circumstances. However, it should also be noted that there are approaches that appear highly critical against valorized conceptions of entrepreneurs. For example, there are views that attribute pertinent conceptions to scholarly prejudices, such as unrealistically voluntaristic preconceptions on how a "normal" economic agent ought to behave (Ramoglou, 2011; Gartner, 2001).

Psychological studies show that the psychological propensities for male and [female entrepreneurs](http://en.wikipedia.org/wiki/Female_entrepreneur) are more similar than different. Perceived gender differences may be due more to gender stereotyping. There is a growing body of work that shows that entrepreneurial behavior is dependent on social and economic factors. For example, countries which have healthy and diversified labor markets or stronger safety nets show a more favorable ratio of opportunity-driven rather than necessity-driven women entrepreneurs. Empirical studies suggest that men entrepreneurs possess strong negotiating skills and consensus-forming abilities.

## Types of entrepreneurs

The literature has distinguished among a number of different types of entrepreneurs, for instance:

### Social entrepreneur

A [social entrepreneur](http://en.wikipedia.org/wiki/Social_entrepreneurship) is motivated by a desire to help, improve and transform  [social](http://en.wikipedia.org/wiki/Social), [environmental](http://en.wikipedia.org/wiki/Environment_(biophysical)), [educational](http://en.wikipedia.org/wiki/Educational) and [economic](http://en.wikipedia.org/wiki/Economic) conditions. Key [traits](http://en.wikipedia.org/wiki/Traits) and characteristics of highly effective social entrepreneurs include ambition and a lack of acceptance of the [status quo](http://en.wikipedia.org/wiki/Status_quo) or accepting the world "as it is". The social entrepreneur is driven by an [emotional](http://en.wikipedia.org/wiki/Emotional) desire to address some of the big social and economic conditions in the world, for example, [poverty](http://en.wikipedia.org/wiki/Poverty) and educational deprivation, rather than by the desire for [profit](http://en.wikipedia.org/wiki/Profit_(economics)). Social entrepreneurs seek to develop [innovative](http://en.wikipedia.org/wiki/Innovative) solutions to global problems that can be copied by others to enact change.

Social entrepreneurs act within a market aiming to create social value through the improvement of goods and services offered to the community. Their main aim is to help offer a better service improving the community as a whole and are predominately run as non profit schemes. Zahra et al. (2009: 519) said that “social entrepreneurs make significant and diverse contributions to their communities and societies, adopting business models to offer creative solutions to complex and persistent social problems”.

### Serial entrepreneur

A serial entrepreneur is one who continuously comes up with new ideas and starts new businesses.[[4]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-6) In the media, the serial entrepreneur is represented as possessing a higher propensity for risk, innovation and achievement.[[5]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-7)

### Lifestyle entrepreneur

A lifestyle entrepreneur places passion before [profit](http://en.wikipedia.org/wiki/Profit_(economics)) when launching a business in order to combine personal interests and talent with the ability to earn a living. Many [entrepreneurs](http://en.wikipedia.org/wiki/Entrepreneurs) may be primarily motivated by the intention to make their business profitable in order to sell to [shareholders](http://en.wikipedia.org/wiki/Shareholders).[[*examples needed*](http://en.wikipedia.org/wiki/Wikipedia:Please_clarify)] In contrast, a lifestyle entrepreneur intentionally chooses a [business model](http://en.wikipedia.org/wiki/Business_model) intended to develop and grow their business in order to make a long-term, sustainable and viable living working in a field where they have a particular interest, passion, talent, knowledge or high degree of expertise.[[6]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-8) A lifestyle entrepreneur may decide to become [self-employed](http://en.wikipedia.org/wiki/Self-employed) in order to achieve greater personal freedom, more family time and more time working on projects or business goals that inspire them. A lifestyle entrepreneur may combine a hobby with a profession or they may specifically decide not to expand their business in order to remain in control of their venture. Common goals held by the lifestyle entrepreneur include earning a living doing something that they love, earning a living in a way that facilitates self-employment, achieving a good [work/life balance](http://en.wikipedia.org/wiki/Work/life_balance) and owning a business without shareholders.[[*further explanation needed*](http://en.wikipedia.org/wiki/Wikipedia:Please_clarify)] Many lifestyle entrepreneurs are very dedicated to their business and may work within the [creative industries](http://en.wikipedia.org/wiki/Creative_industries) or [tourism industry](http://en.wikipedia.org/wiki/Tourism_industry),[[7]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-9) where a passion before profit approach to [entrepreneurship](http://en.wikipedia.org/wiki/Entrepreneurship) often prevails. While many entrepreneurs may launch their business with a clear [exit strategy](http://en.wikipedia.org/wiki/Exit_strategy), a lifestyle entrepreneur may deliberately and consciously choose to keep their venture fully within their own control. Lifestyle [entrepreneurship](http://en.wikipedia.org/wiki/Entrepreneurship) is becoming increasing popular as technology provides [small business](http://en.wikipedia.org/wiki/Small_business)owners with the digital platforms needed to reach a large [global market](http://en.wikipedia.org/wiki/Global_market).[[8]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-10) Younger lifestyle entrepreneurs, typically those between 25 and 40 years old, are sometimes referred to as Treps.[[9]](http://en.wikipedia.org/wiki/Entrepreneur#cite_note-11)

### Cooperative entrepreneur

A cooperative entrepreneur doesn't just work alone, but rather collaborates with other cooperative entrepreneurs to develop projects, particularly cooperative projects. Each cooperative entrepreneur might bring different skill sets to the table, but collectively they share in the risk and success of the venture.

### Theory-based Typologies

Recent advances in entrepreneurship research indicate that the differences in entrepreneurs and heterogeneity in their behaviors and actions can be traced back to their the founder's identity. For instance, Fauchart and Gruber (2011, Academy of Management Journal) have recently shown that -based on social identity theory - three main types of entrepreneurs can be distinguished: Darwinians, Communitarians and Missionaries. These types of founders not only diverge in fundamental ways in terms of their self-views and their social motivations in entrepreneurship, but also engage fairly differently in new firm creation.

## Investor

An **investor** is a party that makes an [investment](http://en.wikipedia.org/wiki/Investment) into one or more categories of assets --- [equity](http://en.wikipedia.org/wiki/Stock), [debt](http://en.wikipedia.org/wiki/Bond_(finance)) [securities](http://en.wikipedia.org/wiki/Security_(finance)), [real estate](http://en.wikipedia.org/wiki/Real_estate), [currency](http://en.wikipedia.org/wiki/Currency), [commodity](http://en.wikipedia.org/wiki/Commodity), derivatives such as put and call options, etc. --- with the objective of making a [profit](http://en.wikipedia.org/wiki/Profit_(economics)). This definition makes no distinction between those in the primary and secondary markets. That is, someone who provides a business with capital and someone who buys a stock are both investors. Since those in the secondary market are considered investors, speculators are also investors. According to this definition there is no difference.

## Types of investors

The following classes of investors are not mutually exclusive:

* Individual investors (including [trusts](http://en.wikipedia.org/wiki/Trust_(property)) on behalf of individuals, and umbrella companies formed by two or more to pool investment funds)
* [Collectors](http://en.wikipedia.org/wiki/Collecting) of [art](http://en.wikipedia.org/wiki/Art), [antiques](http://en.wikipedia.org/wiki/Antiques), and other things of value
* [Angel investors](http://en.wikipedia.org/wiki/Angel_investors) (individuals and groups)
* [Sweat equity](http://en.wikipedia.org/wiki/Sweat_equity) investor
* [Venture capital](http://en.wikipedia.org/wiki/Venture_capital) funds, which serve as investment collectives on behalf of individuals, companies, pension plans, insurance reserves, or other funds.
* [Businesses](http://en.wikipedia.org/wiki/Businesses) that make investments, either directly or via a [captive fund](http://en.wikipedia.org/w/index.php?title=Captive_fund&action=edit&redlink=1)
* [Investment trusts](http://en.wikipedia.org/wiki/Investment_trust), including [real estate investment trusts](http://en.wikipedia.org/wiki/Real_estate_investment_trust)
* [Mutual funds](http://en.wikipedia.org/wiki/Mutual_funds), [hedge funds](http://en.wikipedia.org/wiki/Hedge_funds), and other funds, ownership of which may or may not be [publicly traded](http://en.wikipedia.org/wiki/Publicly_traded) (these funds typically pool money raised from their owner-subscribers to invest in securities)
* [Sovereign wealth funds](http://en.wikipedia.org/wiki/Sovereign_wealth_fund)

Also, investors might be classified according to their [styles](http://en.wikipedia.org/wiki/Investor_style). In this respect, an important distinctive [investor psychology](http://en.wikipedia.org/wiki/Investor_psychology) trait is [risk attitude](http://en.wikipedia.org/wiki/Risk_aversion).

## Investor protection

The term “investor protection” defines the entity of efforts and activities to observe, safeguard and enforce the rights and claims of a person in his role as an investor. This includes advise and legal action. The assumption of a need of protection is based on the experience that financial investors are usually structurally inferior to providers of financial services and products due to lack of professional knowledge, information and/or experience. Countries with stronger investor protections tend to grow faster than those with poor investor protections.

## Investment

**Investment** has different meanings in finance and economics. Finance investment is putting money into something with the expectation of gain that upon thorough analysis, has a high degree of security for the principal amount, as well as security of return, within an expected period of time.[[1]](http://en.wikipedia.org/wiki/Investment#cite_note-0) In contrast putting money into something with an expectation of gain without thorough analysis, without security of principal, and without security of return is [speculation](http://en.wikipedia.org/wiki/Speculation) or [gambling](http://en.wikipedia.org/wiki/Gambling). As such, those shareholders who fail to thoroughly analyze their stock purchases, such as owners of mutual funds, could well be called speculators. Indeed, given the efficient market hypothesis, which implies that a thorough analysis of stock data is irrational, all rational shareholders are, by definition, not investors, but speculators.

Investment is related to [saving](http://en.wikipedia.org/wiki/Saving_(money)) or deferring [consumption](http://en.wikipedia.org/wiki/Consumption_(economics)). Investment is involved in many areas of the [economy](http://en.wikipedia.org/wiki/Economy), such as [business management](http://en.wikipedia.org/wiki/Business_management) and [finance](http://en.wikipedia.org/wiki/Finance) whether for households, firms, or governments.

To avoid speculation an investment must be either directly backed by the pledge of sufficient [collateral](http://en.wikipedia.org/wiki/Collateral_(finance)) or insured by sufficient assets pledged by a third party. A thoroughly analyzed loan of money backed by collateral with greater immediate value than the loan amount may be considered an investment. A financial instrument that is insured by the pledge of assets from a third party, such as a deposit in a financial institution insured by a government agency may be considered an investment. Examples of these agencies include, in the United States, the [Securities Investor Protection Corporation](http://en.wikipedia.org/wiki/Securities_Investor_Protection_Corporation), [Federal Deposit Insurance Corporation](http://en.wikipedia.org/wiki/Federal_Deposit_Insurance_Corporation), or [National Credit Union Administration](http://en.wikipedia.org/wiki/National_Credit_Union_Administration), or in Canada, the [Canada Deposit Insurance Corporation](http://en.wikipedia.org/wiki/Canada_Deposit_Insurance_Corporation).

## In economics or macroeconomics

In [economic theory](http://en.wikipedia.org/wiki/Economic_theory) or in [macroeconomics](http://en.wikipedia.org/wiki/Macroeconomics), investment is the amount purchased per unit time of [goods](http://en.wikipedia.org/wiki/Good_(economics_and_accounting)) which are not consumed but are to be used for future production (ie. [capital](http://en.wikipedia.org/wiki/Capital_(economics))). Examples include [railroad](http://en.wikipedia.org/wiki/Railroad) or [factory](http://en.wikipedia.org/wiki/Factory) construction. Investment in[human capital](http://en.wikipedia.org/wiki/Human_capital) includes costs of additional schooling or on-the-job training. [Inventory investment](http://en.wikipedia.org/wiki/Inventory_investment) is the accumulation of goods [inventories](http://en.wikipedia.org/wiki/Inventories); it can be positive or negative, and it can be intended or unintended. In [measures of national income and output](http://en.wikipedia.org/wiki/Measures_of_national_income_and_output), "gross investment" (represented by the [variable](http://en.wikipedia.org/wiki/Variable_(mathematics)) I) is also a component of [gross domestic product](http://en.wikipedia.org/wiki/Gross_domestic_product) (GDP), given in the formula GDP = C + I + G + NX, where C is consumption, G is government spending, and NX is net exports. Thus investment is everything that remains of total expenditure after consumption, government spending, and net exports are subtracted (i.e. I = GDP − C − G − NX).

Non-residential fixed investment (such as new factories) and residential investment (new houses) combine with inventory investment to make up I. "Net investment" deducts [depreciation](http://en.wikipedia.org/wiki/Depreciation) from gross investment. Net fixed investment is the value of the net increase in the capital stock per year.

Fixed investment, as expenditure over a period of time ("per year"), is not [capital](http://en.wikipedia.org/wiki/Capital_(economics)). The time dimension of investment makes it a [*flow*](http://en.wikipedia.org/wiki/Stock_and_flow). By contrast, capital is a *stock*— that is, accumulated net investment *to a point* in time (such as December 31).

Investment is often modeled as a function of Income and Interest rates, given by the relation I = f(Y, r). An increase in income encourages higher investment, whereas a higher interest rate may discourage investment as it becomes more costly to borrow money. Even if a firm chooses to use its own funds in an investment, the interest rate represents an [opportunity cost](http://en.wikipedia.org/wiki/Opportunity_cost) of investing those funds rather than lending out that amount of money for interest.

## In finance

In [finance](http://en.wikipedia.org/wiki/Finance), investment is the commitment of funds through collateralized lending, or making a deposit into a secured institution.

In contrast to investment; dollar cost averaging, [market timing](http://en.wikipedia.org/wiki/Market_timing), and diversification are phrases associated with speculation.

Investments are often made indirectly through [intermediaries](http://en.wikipedia.org/wiki/Intermediary), such as [banks](http://en.wikipedia.org/wiki/Bank), [credit unions](http://en.wikipedia.org/wiki/Credit_union), [brokers](http://en.wikipedia.org/wiki/Broker), [lenders](http://en.wikipedia.org/wiki/Lender), and [insurance](http://en.wikipedia.org/wiki/Insurance) companies. Though their legal and procedural details differ, an intermediary generally makes an investment using money from many individuals, each of whom receives a claim on the intermediary.

# X Accounting

**Accountancy** is the process of communicating financial information about a [business entity](http://en.wikipedia.org/wiki/Business_entity) to users such as [shareholders](http://en.wikipedia.org/wiki/Shareholders) and [managers](http://en.wikipedia.org/wiki/Managers).[[1]](http://en.wikipedia.org/wiki/Accountancy#cite_note-0) The [communication](http://en.wikipedia.org/wiki/Communication) is generally in the form of [financial statements](http://en.wikipedia.org/wiki/Financial_statements) that show in money terms the [economic resources](http://en.wikipedia.org/wiki/Factors_of_production) under the control of management; the art lies in selecting the information that is relevant to the user and is reliable.[[2]](http://en.wikipedia.org/wiki/Accountancy#cite_note-1) The [principles](http://en.wikipedia.org/wiki/Principle) of accountancy are applied to business entities in three divisions of practical art, named accounting, [bookkeeping](http://en.wikipedia.org/wiki/Bookkeeping), and [auditing](http://en.wikipedia.org/wiki/Auditing).[[3]](http://en.wikipedia.org/wiki/Accountancy#cite_note-2)

The [American Institute of Certified Public Accountants](http://en.wikipedia.org/wiki/American_Institute_of_Certified_Public_Accountants) (AICPA) defines accountancy as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof."[[4]](http://en.wikipedia.org/wiki/Accountancy#cite_note-3)

Accounting is thousands of years old; the earliest accounting records, which date back more than 7,000 years, were found in [Mesopotamia](http://en.wikipedia.org/wiki/Mesopotamia) ([Assyrians](http://en.wikipedia.org/wiki/Assyrians)). The people of that time relied on primitive accounting methods to record the growth of crops and herds. Accounting evolved, improving over the years and advancing as business advanced

Early accounts served mainly to assist the memory of the [businessperson](http://en.wikipedia.org/wiki/Businessperson) and the audience for the account was the [proprietor](http://en.wikipedia.org/wiki/Sole_proprietorship) or record keeper alone. Cruder forms of accounting were inadequate for the problems created by a business entity involving multiple [investors](http://en.wikipedia.org/wiki/Investors), so [double-entry bookkeeping](http://en.wikipedia.org/wiki/Double-entry_bookkeeping) first emerged in northern Italy in the 14th century, where trading ventures began to require more [capital](http://en.wikipedia.org/wiki/Financial_capital) than a single individual was able to invest. The development of [joint stock companies](http://en.wikipedia.org/wiki/Joint_stock_companies) created wider audiences for accounts, as investors without firsthand knowledge of their [operations](http://en.wikipedia.org/wiki/Business_operations) relied on accounts to provide the requisite information.[[6]](http://en.wikipedia.org/wiki/Accountancy#cite_note-5) This development resulted in a split of accounting systems for internal (i.e. [management accounting](http://en.wikipedia.org/wiki/Management_accounting)) and external (i.e. [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting)) purposes, and subsequently also in accounting and disclosure regulations and a growing need for independent attestation of external accounts by [auditors](http://en.wikipedia.org/wiki/Auditors).

Today, accounting is called "the language of business" because it is the vehicle for reporting financial information about a business entity to many different groups of people. Accounting that concentrates on reporting to people inside the business entity is called [management accounting](http://en.wikipedia.org/wiki/Management_accounting) and is used to provide information to employees, managers, [owner-managers](http://en.wikipedia.org/wiki/Self-employment) and [auditors](http://en.wikipedia.org/wiki/Auditors). Management accounting is concerned primarily with providing a basis for making management or operating decisions. Accounting that provides information to people outside the business entity is called [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting) and provides information to present and potential shareholders, [creditors](http://en.wikipedia.org/wiki/Creditors) such as [banks](http://en.wikipedia.org/wiki/Bank) or vendors, [financial analysts](http://en.wikipedia.org/wiki/Financial_analysts), [economists](http://en.wikipedia.org/wiki/Economists), and [government agencies](http://en.wikipedia.org/wiki/Government_agencies). Because these users have different needs, the presentation of financial accounts is very structured and subject to many more rules than management accounting. The body of rules that governs financial accounting in a given jurisdiction is called. [Generally Accepted Accounting Principles](http://en.wikipedia.org/wiki/Generally_Accepted_Accounting_Principles), or GAAP. Other rules include [International Financial Reporting Standards](http://en.wikipedia.org/wiki/International_Financial_Reporting_Standards), or IFRS,[[8]](http://en.wikipedia.org/wiki/Accountancy#cite_note-7) or US GAAP.

## Accountant

An **accountant** is a practitioner of [accountancy](http://en.wikipedia.org/wiki/Accountancy) (UK) or accounting (US), which is the measurement, disclosure or provision of assurance about financial information that helps managers, investors, tax authorities and others make decisions about allocating resources.

The [Big Four auditors](http://en.wikipedia.org/wiki/Big_Four_auditors) are the largest employers of accountants worldwide. However, most accountants are employed in commerce, industry and the [public sector](http://en.wikipedia.org/wiki/Public_sector).

## British Commonwealth

In the [Commonwealth of Nations](http://en.wikipedia.org/wiki/Commonwealth_of_Nations), which includes the [United Kingdom](http://en.wikipedia.org/wiki/United_Kingdom), [Canada](http://en.wikipedia.org/wiki/Canada), [Australia](http://en.wikipedia.org/wiki/Australia), [New Zealand](http://en.wikipedia.org/wiki/New_Zealand), [Hong Kong](http://en.wikipedia.org/wiki/Hong_Kong) pre 1997 and several dozen other states, commonly recognized accounting qualifications are [Chartered Accountant](http://en.wikipedia.org/wiki/Chartered_Accountant) (CA or ACA), [Chartered Certified Accountant](http://en.wikipedia.org/wiki/Chartered_Certified_Accountant) ([ACCA](http://en.wikipedia.org/wiki/Association_of_Chartered_Certified_Accountants)), Chartered Management Accountant (ACMA) and International Accountant (AAIA). Other qualifications in particular countries include Certified Public Accountant (CPA – Ireland and CPA – Hong Kong), Certified Management Accountant (CMA – Canada), Certified General Accountant (CGA – Canada), Certified Practising Accountant (CPA – Australia) and members of the [Institute of Public Accountants](http://en.wikipedia.org/wiki/Institute_of_Public_Accountants) (Australia), and Certified Public Practising Accountant (CPPA – New Zealand).

The Institute of Chartered Accountants of Scotland (ICAS) received its [Royal Charter](http://en.wikipedia.org/wiki/Royal_Charter) in 1854 and is the world's first [professional body](http://en.wikipedia.org/wiki/Professional_body) of accountants.

### United Kingdom

* A [**Chartered Accountant**](http://en.wikipedia.org/wiki/Chartered_Accountant) must be a member of one of the following:
  + the [Institute of Chartered Accountants in England & Wales](http://en.wikipedia.org/wiki/Institute_of_Chartered_Accountants_in_England_%26_Wales) (ICAEW) (designatory letters ACA or FCA)
  + the [Institute of Chartered Accountants of Scotland](http://en.wikipedia.org/wiki/Institute_of_Chartered_Accountants_of_Scotland) (ICAS) (designatory letters CA)
  + [Chartered Accountants Ireland](http://en.wikipedia.org/wiki/Chartered_Accountants_Ireland) (CAI)
  + a recognised equivalent body from another Commonwealth country (designatory letters being CA (name of country) e.g. CA (Canada))
* A [**Chartered Certified Accountant**](http://en.wikipedia.org/wiki/Chartered_Certified_Accountant) must be a member of the [Association of Chartered Certified Accountants](http://en.wikipedia.org/wiki/Association_of_Chartered_Certified_Accountants) (designatory letters ACCA or FCCA).
* A **Chartered Management Accountant** must be a member of the [Chartered Institute of Management Accountants](http://en.wikipedia.org/wiki/Chartered_Institute_of_Management_Accountants) (designatory letters ACMA or FCMA).
* A **Chartered Public Finance Accountant** must be a member of the [Chartered Institute of Public Finance and Accountancy](http://en.wikipedia.org/wiki/Chartered_Institute_of_Public_Finance_and_Accountancy) (designatory letters CPFA).
* An **International Accountant** is a member of the [Association of International Accountants](http://en.wikipedia.org/wiki/Association_of_International_Accountants) (designatory letters AIAA or FAIA).
* An **Incorporated Financial Accountant** is a member of the [Institute of Financial Accountants](http://en.wikipedia.org/wiki/Institute_of_Financial_Accountants) (designatory letters AFA or FFA).
* An **Associate Professional Accountant** is a member of the Institute of Professional Accountants(designatory letters APA-UK or FPA).[[3]](http://en.wikipedia.org/wiki/Accountant#cite_note-2)[[*importance?*](http://en.wikipedia.org/wiki/Wikipedia:INDISCRIMINATE)]
* A **Certified Public Accountant** may be a member of the [Association of Certified Public Accountants](http://en.wikipedia.org/wiki/Association_of_Certified_Public_Accountants) (designatory letters AICPA or FCPA) or its equivalent in another country, and is usually designated as such after passing the [Uniform Certified Public Accountant Examination](http://en.wikipedia.org/wiki/Uniform_Certified_Public_Accountant_Examination).
* A **Public Accountant** may be a member of the [Institute of Public Accountants](http://en.wikipedia.org/wiki/Institute_of_Public_Accountants) (designatory letters AIPA, MIPA or FIPA).

Excepting the Association of Certified Public Accountants, each of the above bodies admits members only after passing examinations and undergoing a period of relevant work experience. Once admitted, members are expected to comply with ethical guidelines and gain appropriate professional experience.

Chartered, Chartered Certified, Chartered Public Finance, and International Accountants engaging in practice (i.e. selling services to the public rather than acting as an employee) must gain a "practicing certificate" by meeting further requirements such as purchasing adequate insurance and undergoing inspections.

The ICAEW, ICAS, ICAI, ACCA, AIA and CIPFA are six statutory **RQB** Qualification Bodies in the UK. A member of one them may also become a *Registered Auditor* in accordance with the Companies Act, providing they can demonstrate the necessary professional ability in that area and submit to regular inspection. It is illegal for any individual or firm that is not a Registered Auditor to perform a company audit.

All six RQBs are listed under EU mutual recognition directives to practice in 27 EU member states and individually entered into agreement with the Hong Kong Institute of Certified Public Accountants (HKICPA).

Further restrictions apply to accountants who carry out insolvency work.

In addition to the bodies above, technical qualifications are offered by the [Association of Accounting Technicians](http://en.wikipedia.org/wiki/Association_of_Accounting_Technicians), ACCA and AIA, which are respectively called AAT Technician, CAT ([Certified Accounting Technician](http://en.wikipedia.org/wiki/Certified_Accounting_Technician)) and IAT (International Accounting Technician).

### Australia

In Australia, there are three legally recognised professional accounting bodies: the [Institute of Public Accountants](http://en.wikipedia.org/wiki/Institute_of_Public_Accountants) (IPA), [CPA Australia](http://en.wikipedia.org/wiki/CPA_Australia) (CPA) and the [Institute of Chartered Accountants of Australia](http://en.wikipedia.org/wiki/Institute_of_Chartered_Accountants_of_Australia) (ICAA).

### Canada

In Canada, there are four recognized accounting bodies: the [Canadian Institute of Chartered Accountants](http://en.wikipedia.org/wiki/Canadian_Institute_of_Chartered_Accountants) (CA) and the provincial and territorial CA Institutes, the [Society of Management Accountants of Canada](http://en.wikipedia.org/wiki/Society_of_Management_Accountants_of_Canada), also known as the Certified Management Accountants (CMA), [the Certified General Accountants Association of Canada](http://en.wikipedia.org/wiki/Certified_General_Accountant) (CGA), and the Society of Professional Accountants of Canada (RPA). CA and CGA were created by Acts of Parliament in 1902 and 1913 respectively, CMA was established in 1920 and RPA in 1938.

The CA program is the most focused on public accounting and most candidates obtain auditing experience from public accounting firms, although recent changes allow candidates to obtain their experience requirements in industry at companies that have been accredited for training CAs; the CMA program focuses in management accounting, but also provides a general approach to financial accounting and tax; the CGA program takes a general approach allowing candidates to focus in their own financial career choices. The CA and CMA programs require a candidate to obtain a degree as a program entry requirement. The CGA program requires a degree as an exit requirement prior to certification.

Auditing and public accounting are regulated by the provinces. In [British Columbia](http://en.wikipedia.org/wiki/British_Columbia) and [Prince Edward Island](http://en.wikipedia.org/wiki/Prince_Edward_Island), CAs and CGAs have equal status regarding public accounting and auditing; In the rest of [Canada](http://en.wikipedia.org/wiki/Canada), CAs, CMAs, and CGAs are considered equivalents pursuant to provincial and territorial legislation. However, in practice, most public accounting and auditing in Canada is performed by CAs.

As of 2006, the Chartered Certified Accountant ([ACCA](http://en.wikipedia.org/wiki/Association_of_Chartered_Certified_Accountants) or FCCA) is also recognized by the Canadian government as an eligible qualification to audit federal government institutions in Canada. Furthermore, The Canadian branch of [ACCA](http://en.wikipedia.org/wiki/Association_of_Chartered_Certified_Accountants) is pursuing recognition for statutory audit purposes in the province of Ontario under the province's Public Accounting Act of 2004.

### New Zealand

In New Zealand, there are two local accountancy bodies the [New Zealand Institute of Chartered Accountants](http://en.wikipedia.org/wiki/New_Zealand_Institute_of_Chartered_Accountants) (NZICA) and the New Zealand Association of Certified Public Accountants (NZACPA) the operating name of New Zealand Association of Accountants Inc (NZAA).

To audit public companies an individual must be a member of either the NZICA or an otherwise gazetted body. Chartered Certified Accountant (Association of Chartered Certified Accountants or FCCA) qualification has also been gazetted under). An ACCA member can practice as long as they hold an ACCA public practice certificate (with audit qualification) in their country of origin.

### Sri Lanka

In Sri Lanka, a chartered accountant must be a member of the [Institute of Chartered Accountants of Sri Lanka](http://en.wikipedia.org/wiki/Institute_of_Chartered_Accountants_of_Sri_Lanka) (designatory letters ACA or FCA), therefore it is the sole local accountancy body. To audit public companies an individual must be a member of the ICASL.

## Austria

In Austria the accountancy profession is regulated by the Bilanzbuchhaltungsgesetz 2006 (BibuG – Management Accountancy Law).

## Hong Kong

In [Hong Kong](http://en.wikipedia.org/wiki/Hong_Kong), the accountancy industry is regulated by the [HKICPA](http://en.wikipedia.org/wiki/HKICPA) under the Professional Accountants Ordinance (Chapter 50, Laws of [Hong Kong](http://en.wikipedia.org/wiki/Hong_Kong)). The auditing industry for limited companies is regulated under the Companies Ordinance (Chapter 32, Laws of [Hong Kong](http://en.wikipedia.org/wiki/Hong_Kong)), and other ordinances such as the securities and futures ordinance, the listing rules, etc.

HKICPA terminated all recognition of oversea bodies in 2005 for *accreditation* under professional accountants ordinance. In general, all British RQBs except for CIPFA were re-accredited. Please refer to HKICPA for latest recognition.

**Removal of requirement for a qualified accountant in the Listing Rules of Hong Kong**  
In November 2008, the Stock Exchange of Hong Kong Limited has removed the requirement for a qualified accountant from the listing rules but expanded the Code Provisions in the Code on Corporate Governance Practices regarding internal controls to make specific references to the responsibility of the directors to conduct an annual review of the adequacy of staffing of the financial reporting function and the oversight role of the audit committee.

## Portugal

In Portugal, there are two accountancy qualifications: the *Técnicos Oficiais de Contas* (TOC), responsible for producing accounting and tax information, and the *Revisor Oficial de Contas* (ROC), more related to auditing practices. The TOC certification is exclusively awarded by the professional organization [*Ordem dos Técnicos Oficiais de Contas*](http://en.wikipedia.org/wiki/Ordem_dos_T%C3%A9cnicos_Oficiais_de_Contas) (OTOC), and the certification to become an auditor is awarded by another professional organization, the *Ordem dos Revisores Oficiais de Contas*(OROC).[[4]](http://en.wikipedia.org/wiki/Accountant#cite_note-3) In general, accountants or auditors accredited by OTOC or OROC are individuals with [university](http://en.wikipedia.org/wiki/University) graduation diplomas in business management, economics, mathematics or law who, after further studies, applied for an exam and received the certification to be a TOC or ROC. That certification is only received after a 1-year (TOC) or 3-years (ROC) internship. Any citizen having a [polytechnic](http://en.wikipedia.org/wiki/Polytechnic_(Portugal)) degree as [accounting technician](http://en.wikipedia.org/wiki/Accounting_technician) is also entitled to apply for the exam and certification at the OTOC.

## United States

In the United States, licensed accountants are [Certified Public Accountants](http://en.wikipedia.org/wiki/Certified_Public_Accountant) (CPAs) and in certain states, Public Accountants (PAs). Unlicensed accountants may be [Certified Internal Auditors](http://en.wikipedia.org/wiki/Certified_Internal_Auditor) (CIAs), [Certified Management Accountants](http://en.wikipedia.org/wiki/Certified_Management_Accountant) (CMAs) and [Accredited Business Accountants](http://en.wikipedia.org/wiki/Accredited_Business_Accountant) (ABAs). The difference between these certifications is primarily the legal status and the types of services provided, although individuals may earn more than one certification. Additionally, much accounting work is performed by uncertified individuals, who may be working under the supervision of a certified accountant. As noted above the majority of accountants work in the private sector or may offer their services without the need for certification.

A CPA is licensed by a state to provide auditing services to the public. Many CPA firms also offer accounting, tax, litigation support, and other financial advisory services. The requirements for receiving the CPA license vary from state to state, although the passage of the [Uniform Certified Public Accountant Examination](http://en.wikipedia.org/wiki/Uniform_Certified_Public_Accountant_Examination) is required by all states. This examination is designed and graded by the [American Institute of Certified Public Accountants](http://en.wikipedia.org/wiki/American_Institute_of_Certified_Public_Accountants).

A PA (sometimes referred to as LPA - Licensed Public Accountant) is licensed by the state to practice accountancy to a similar extent as are CPAs, except that PAs are generally not permitted to perform audits or reviews. (Delaware is an exception, in that PAs are permitted to perform audits and reviews.) A PA's ability to practice out of state is very limited due to most states having phased out the PA designation. While most states no longer accept new PA license applicants, approximately 10 states still accept PA applicants for limited practice privileges within the state. As with the CPA, the requirements for receiving the PA license vary from state to state. Most states require a passage of either 2 or 3 (out of 4) sections of the CPA exam or passage of the Comprehensive Examination for Accreditation in Accounting which is administered and graded by the [Accreditation Council for Accountancy and Taxation](http://en.wikipedia.org/w/index.php?title=Accreditation_Council_for_Accountancy_and_Taxation&action=edit&redlink=1) (ACAT).

A certified internal auditor (CIA) is granted a certificate from the Institute of Internal Auditors (IIA), provided that the candidate has passed a four part examination. One of the four parts is waived if the candidate has already passed the CPA Exam. A CIA typically provides services directly to an employer rather than to the public.

A person holding the Certificate in Management Accounting (CMA) is granted the certificate by the Institute of Management Accountants (IMA), provided that the candidate has passed an examination of two parts and has met the practical experience requirement of the IMA. A CMA provides services directly to employers rather than to the public. A CMA can also provide services to the public, but to an extent much lesser than that of a CPA.

An person holding the ABA credential is granted accreditation from the [Accreditation Council for Accountancy and Taxation](http://en.wikipedia.org/w/index.php?title=Accreditation_Council_for_Accountancy_and_Taxation&action=edit&redlink=1) (ACAT), provided that the candidate has passed the eight-hour Comprehensive Examination for Accreditation in Accounting which tests proficiency in financial accounting, reporting, statement preparation, taxation, business consulting services, business law, and ethics. An ABA specializes in the needs of small-to-mid-size businesses and in financial services to individuals and families. In states where use of the word "accountant” is not permitted by non-licensed individuals, the practitioner may use the designation Accredited Business Adviser.

The [United States Department of Labor](http://en.wikipedia.org/wiki/United_States_Department_of_Labor)'s [Bureau of Labor Statistics](http://en.wikipedia.org/wiki/Bureau_of_Labor_Statistics) estimates that there are about one million persons employed as accountants and auditors in the U.S.

[U.S. tax law](http://en.wikipedia.org/wiki/Taxation_in_the_United_States) grants accountants a limited form of [accountant-client privilege](http://en.wikipedia.org/wiki/Accountant-client_privilege).

## Accounting period

**Accounting period** in [bookkeeping](http://en.wikipedia.org/wiki/Bookkeeping) is the period with reference to which accounting books of any entity are prepared.

It is the period for which books are balanced and the financial statements are prepared. Generally, the accounting period consists of 12 months. However the beginning of the accounting period differs according to the jurisdiction. For example one entity may follow the regular calendar year, i.e. January to December as the accounting year, while another entity may follow April to March as the accounting period.

The [International Financial Reporting Standards](http://en.wikipedia.org/wiki/International_Financial_Reporting_Standards) even allows a period of 52 weeks as an accounting period instead of a proper year.[[1]](http://en.wikipedia.org/wiki/Accounting_period#cite_note-0)

In some of the ERP tools there are more than 12 accounting periods in a financial year. They put one accounting period as "Year Open" period where all the carried over balances from last financial year are cleared and one period as "Year Close" where all the transactions for closed for the same financial year. Accounting is an art of recording classifying and summarising the financial positions of the company. It is done by the accountant.

## Bookkeeping

**Bookkeeping** is the recording of financial transactions. Transactions include sales, purchases, income, receipts and payments by an individual or organization. Bookkeeping is usually performed by a bookkeeper. Many individuals mistakenly consider bookkeeping and accounting to be the same thing. This confusion is understandable because the accounting process includes the bookkeeping function, but is just one part of the accounting process.[[1]](http://en.wikipedia.org/wiki/Bookkeeping#cite_note-Weygandt.2C_Kieso.2C_Kimmel_.282003.29-0) The accountant creates reports from the recorded financial transactions recorded by the bookkeeper and files forms with government agencies. There are some common methods of bookkeeping such as the [single-entry bookkeeping system](http://en.wikipedia.org/wiki/Single-entry_bookkeeping_system) and the [double-entry bookkeeping system](http://en.wikipedia.org/wiki/Double-entry_bookkeeping_system). But while these systems may be seen as "real" bookkeeping, any process that involves the recording of financial transactions is a bookkeeping process.

A bookkeeper (or book-keeper), also known as an accounting clerk or accounting technician, is a person who records the day-to-day financial transactions of an organization. A bookkeeper is usually responsible for writing the "daybooks". The daybooks consist of purchases, sales, receipts, and payments. The bookkeeper is responsible for ensuring all transactions are recorded in the correct day book, suppliers ledger, customer ledger and general ledger.

The bookkeeper brings the books to the [trial balance](http://en.wikipedia.org/wiki/Trial_balance) stage. An accountant may prepare the [income statement](http://en.wikipedia.org/wiki/Income_statement) and [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) using the trial balance and ledgers prepared by the bookkeeper.

## Chart of accounts

A **chart of accounts** (**COA**) is a created list of the [accounts](http://en.wikipedia.org/wiki/Nominal_ledger) used by a [business entity](http://en.wikipedia.org/wiki/Business_entity) to define each class of items for which money or the equivalent is spent or received. It is used to organize the finances of the entity and to segregate expenditures, revenue, assets and liabilities in order to give interested parties a better understanding of the financial health of the entity.

The list can be numerical, alphabetic, or alpha-numeric. The structure and headings of accounts should assist in consistent posting of transactions. Each nominal ledger account is unique to allow its [ledger](http://en.wikipedia.org/wiki/Ledger) to be located. The list is typically arranged in the order of the customary appearance of accounts in the financial statements, balance sheet accounts followed by profit and loss accounts.

## Types of accounts

1. [**Asset**](http://en.wikipedia.org/wiki/Asset)**accounts**: represent the different types of economic resources owned or controlled by business, common examples of Asset accounts are cash, cash in bank, building, inventory, prepaid rent, goodwill, accounts receivable[[1]](http://en.wikipedia.org/wiki/Chart_of_accounts#cite_note-0)
2. [**Liability**](http://en.wikipedia.org/wiki/Liability_(financial_accounting))**accounts**: represent the different types of economic obligations by a business, such as accounts payable, bank loan, bonds payable, accrued interest.[[*citation needed*](http://en.wikipedia.org/wiki/Wikipedia:Citation_needed)]
3. [**Equity**](http://en.wikipedia.org/wiki/Ownership_equity)**accounts**: represent the residual equity of a business (after deducting from Assets all the liabilities) including Retained Earnings and Appropriations.
4. [**Revenue**](http://en.wikipedia.org/wiki/Revenue)**accounts** or [**income**](http://en.wikipedia.org/wiki/Income): represent the company's gross earnings and common examples include Sales, Service revenue and Interest Income.
5. [**Expense**](http://en.wikipedia.org/wiki/Expense)**accounts**: represent the company's expenditures to enable itself to operate. Common examples are electricity and water, rentals, depreciation, doubtful accounts, interest, insurance.
6. [**Contra-accounts**](http://en.wikipedia.org/wiki/Contra-accounts): Some balance sheet items have corresponding contra accounts, with negative balances, that offset them. Examples are [accumulated depreciation](http://en.wikipedia.org/wiki/Accumulated_depreciation) against equipment, and [allowance for bad debts](http://en.wikipedia.org/wiki/Allowance_for_bad_debts) against long-term notes receivable.

## General ledger

The **general ledger** is the main accounting record of a business which uses [double-entry bookkeeping](http://en.wikipedia.org/wiki/Double-entry_bookkeeping). It will usually include [accounts](http://en.wikipedia.org/wiki/Account_(accountancy)) for such items as current [assets](http://en.wikipedia.org/wiki/Assets), fixed assets, liabilities, revenue and expense items, gains and losses. Each General Ledger is divided into debits and credits sections. The left hand side lists debit transactions and the right hand side lists credit transactions. This gives a 'T' shape to each individual general ledger account.

A "T" account showing debits on the left and credits on the right.

|  |  |
| --- | --- |
| **Debits** | **Credits** |
|  |  |
|  |  |
|  |  |
|  |  |

The general ledger is a collection of the group of accounts that supports the value items shown in the major financial statements. It is built up by posting transactions recorded in the sales daybook, purchases daybook, cash book and [general journals](http://en.wikipedia.org/wiki/General_journal) daybook. The general ledger can be supported by one or more [subsidiary ledgers](http://en.wikipedia.org/wiki/Subledger) that provide details for accounts in the general ledger. For instance, an [accounts receivable](http://en.wikipedia.org/wiki/Accounts_receivable) subsidiary ledger would contain a separate account for each credit customer, tracking that customer's balance separately. This subsidiary ledger would then be to talled and compared with its [controlling account](http://en.wikipedia.org/wiki/Controlling_account) (in this case, Accounts Receivable) to ensure accuracy as part of the process of preparing a [trial balance](http://en.wikipedia.org/wiki/Trial_balance).

There are five (seven) basic categories in which all accounts are grouped:

1. [Assets](http://en.wikipedia.org/wiki/Assets)
2. [Liability](http://en.wikipedia.org/wiki/Liability_(financial_accounting))
3. [Owner's equity](http://en.wikipedia.org/wiki/Owner%27s_equity)
4. [Revenue](http://en.wikipedia.org/wiki/Revenue)
5. [Expense](http://en.wikipedia.org/wiki/Expense)
6. ([Gains](http://en.wikipedia.org/wiki/Gain_(finance)))
7. ([Loss](http://en.wikipedia.org/wiki/Loss))

The [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) and the [income statement](http://en.wikipedia.org/wiki/Income_statement) are both derived from the general ledger. Each account in the general ledger consists of one or more pages. The general ledger is where posting to the accounts occurs. Posting is the process of recording amounts as credits, (right side), and amounts as debits, (left side), in the pages of the general ledger. Additional columns to the right hold a running activity total (similar to a checkbook).

The listing of the account names is called the [chart of accounts](http://en.wikipedia.org/wiki/Chart_of_accounts). The extraction of account balances is called a [trial balance](http://en.wikipedia.org/wiki/Trial_balance). The purpose of the trial balance is, at a preliminary stage of the [financial statement](http://en.wikipedia.org/wiki/Financial_statement) preparation process, to ensure the equality of the total [debits](http://en.wikipedia.org/wiki/Debits) and [credits](http://en.wikipedia.org/wiki/Debits_and_credits).

The general ledger should include the date, description and balance or total amount for each account. It is usually divided into at least seven main categories. These categories generally include assets, liabilities, owner's equity, revenue, expenses, gains and losses. The main categories of the general ledger may be further subdivided into [subledgers](http://en.wikipedia.org/wiki/Subledger) to include additional details of such accounts as cash, accounts receivable, accounts payable, etc.

Because each bookkeeping entry debits one account and credits another account in an equal amount, the [double-entry bookkeeping](http://en.wikipedia.org/wiki/Double-entry_bookkeeping) system helps ensure that the general ledger is always in balance, thus maintaining the [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation):

\mbox{Assets} = \mbox{Liabilities} + \mbox{(Shareholders or Owners equity)}

The accounting equation is the mathematical structure of the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet). Although a general ledger appears to be fairly simple, in large or complex organizations or organizations with various subsidiaries, the general ledger can grow to be quite large and take several hours or days to audit or balance.

## Asset

In [financial accounting](http://en.wikipedia.org/wiki/Financial_accountancy), **assets** are economic resources. Anything tangible or intangible that is capable of being owned or controlled to produce value and that is held to have positive economic value is considered an asset. Simply stated, assets represent ownership of value that can be converted into cash (although cash itself is also considered an asset).

The [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) of a firm records the monetary value of the assets owned by the firm. It is money and other valuables belonging to an individual or business. Two major asset classes are tangible assets and intangible assets. Tangible assets contain various subclasses, including current assets and fixed assets.[[3]](http://en.wikipedia.org/wiki/Assets#cite_note-FinanceDict-2) Current assets include inventory, while fixed assets include such items as building sand [equipment](http://en.wikipedia.org/wiki/Equipment).

Intangible assets are nonphysical resources and rights that have a value to the firm because they give the firm some kind of advantage in the market place. Examples of intangible assets are goodwill, copyrights, [trademarks](http://en.wikipedia.org/wiki/Trademarks), [patents](http://en.wikipedia.org/wiki/Patents) and [computer programs](http://en.wikipedia.org/wiki/Computer_program), and financial assets, including such items as [accounts receivable](http://en.wikipedia.org/wiki/Accounts_receivable), [bonds](http://en.wikipedia.org/wiki/Bond_(finance)) and [stocks](http://en.wikipedia.org/wiki/Stock).

## Asset characteristics

Other than software companies and the like - employees are not considered as assets, like machinery is, even though they are capable of producing value.

* The probable present benefit involves a capacity, singly or in combination with other assets, in the case of profit oriented enterprises, to contribute directly or indirectly to future net [cash flows](http://en.wikipedia.org/wiki/Cash_flows), and, in the case of [not-for-profit organizations](http://en.wikipedia.org/wiki/Non-profit_organization), to provide services;
* The entity can control access to the benefit;
* The transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred.

In the [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting) sense of the term, it is not necessary to be able to legally enforce the asset's benefit for qualifying a resource as being an asset, provided the entity can control its use by other means.

The [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation) relates assets, liabilities, and [owner's equity](http://en.wikipedia.org/wiki/Ownership_equity):

Assets = Liabilities + Stockholder's Equity (Owner's Equity)

That is, the total value of firms Assets are always equal to the combined value of its "equity" and "[liabilities](http://en.wikipedia.org/wiki/Liability_(accounting))."

The accounting equation is the mathematical structure of the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet).

Assets are listed on the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet). Similarly, in [economics](http://en.wikipedia.org/wiki/Economics) an asset is any form in which [wealth](http://en.wikipedia.org/wiki/Wealth) can be held.

Probably the most accepted accounting definition of asset is the one used by the [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board).[[6]](http://en.wikipedia.org/wiki/Assets#cite_note-5) The following is a quotation from the IFRS Framework: "An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise."

Assets are formally controlled and managed within larger organizations via the use of asset tracking tools. These monitor the purchasing, upgrading, servicing, licensing, disposal etc., of both physical and non-physical assets. In a company's [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) certain divisions are required by [generally accepted accounting principles](http://en.wikipedia.org/wiki/Generally_accepted_accounting_principles) (GAAP), which vary from country to country.

### Current assets

Current assets are cash and other assets expected to be converted to cash, gold, or consumed either in a year or in the operating cycle (whichever is longer), without disturbing the normal operations of a business. These assets are continually turned over in the course of a business during normal business activity. There are 5 major items included into current assets:

1. [**Cash and cash equivalents**](http://en.wikipedia.org/wiki/Cash_and_cash_equivalents) — it is the most [liquid asset](http://en.wikipedia.org/wiki/Market_liquidity), which includes [currency](http://en.wikipedia.org/wiki/Currency), [deposit accounts](http://en.wikipedia.org/wiki/Deposit_account), and [negotiable instruments](http://en.wikipedia.org/wiki/Negotiable_instrument) (e.g., money orders, cheque, bank drafts).
2. [**Short-term investments**](http://en.wikipedia.org/wiki/Investment) — include securities bought and held for sale in the near future to generate income on short-term price differences (trading securities).
3. [**Receivables**](http://en.wikipedia.org/wiki/Receivable) — usually reported as net of allowance for noncollectable accounts.
4. [**Inventory**](http://en.wikipedia.org/wiki/Inventory) — trading these assets is a normal business of a company. The inventory value reported on the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) is usually the historical cost or fair market value, whichever is lower. This is known as the "[lower of cost or market](http://en.wikipedia.org/wiki/Lower_of_cost_or_market)" rule.
5. [**Prepaid expenses**](http://en.wikipedia.org/wiki/Prepaid_expense) — these are expenses paid in cash and recorded as assets before they are used or consumed (a common example is insurance). See also [adjusting entries](http://en.wikipedia.org/wiki/Adjusting_entries).

[Marketable securities](http://en.wikipedia.org/wiki/Marketable_securities) Securities that can be converted into cash quickly at a reasonable price

The phrase *net current assets* (also called [*working capital*](http://en.wikipedia.org/wiki/Working_capital)) is often used and refers to the total of current assets less the total of current [liabilities](http://en.wikipedia.org/wiki/Liability_(accounting)).

### Long-term investments

Often referred to simply as "investments". Long-term investments are to be held for many years and are not intended to be disposed of in the near future. This group usually consists of three types of investments:

1. Investments in securities such as bonds, common stock, or long-term notes.
2. Investments in fixed assets not used in operations (e.g., land held for sale).
3. Investments in special funds (e.g. sinking funds or pension funds).

Different forms of [insurance](http://en.wikipedia.org/wiki/Insurance) may also be treated as long term investments.

### Fixed assets

Also referred to as PPE (property, plant, and equipment), these are purchased for continued and long-term use in earning [profit](http://en.wikipedia.org/wiki/Profit_(economics)) in a business. This group includes as an asset [land](http://en.wikipedia.org/wiki/Land_(economics)), [buildings](http://en.wikipedia.org/wiki/Building), [machinery](http://en.wikipedia.org/wiki/Machinery), [furniture](http://en.wikipedia.org/wiki/Furniture), [tools](http://en.wikipedia.org/wiki/Tool), IT equipments like Laptop etc. and certain wasting resources e.g., timberland and [minerals](http://en.wikipedia.org/wiki/Mineral). They are written off against [profits](http://en.wikipedia.org/wiki/Profit_(accounting)) over their anticipated life by charging [depreciation](http://en.wikipedia.org/wiki/Depreciation) expenses (with exception of land assets). Accumulated depreciation is shown in the face of the balance sheet or in the notes.

These are also called [capital assets](http://en.wikipedia.org/wiki/Capital_asset) in [management accounting](http://en.wikipedia.org/wiki/Management_accounting).

### Intangible assets

Intangible assets lack of physical substance and usually are very hard to evaluate. They include [patents](http://en.wikipedia.org/wiki/Patent), [copyrights](http://en.wikipedia.org/wiki/Copyright), [franchises](http://en.wikipedia.org/wiki/Franchising), [goodwill](http://en.wikipedia.org/wiki/Goodwill_(accounting)), [trademarks](http://en.wikipedia.org/wiki/Trademark), [trade names](http://en.wikipedia.org/wiki/Trade_name), etc. These assets are (according to US GAAP) amortized to expense over 5 to 40 years with the exception of goodwill.

[Websites](http://en.wikipedia.org/wiki/Website) are treated differently in different countries and may fall under either tangible or intangible assets.

### Tangible assets

Tangible assets are those that have a physical substance, such as [currencies](http://en.wikipedia.org/wiki/Currency), [buildings](http://en.wikipedia.org/wiki/Buildings), [real estate](http://en.wikipedia.org/wiki/Real_estate), [vehicles](http://en.wikipedia.org/wiki/Vehicles), [inventories](http://en.wikipedia.org/wiki/Inventory), [equipment](http://en.wikipedia.org/wiki/Equipment), and [precious metals](http://en.wikipedia.org/wiki/Precious_metals) (f.i. [gold](http://en.wikipedia.org/wiki/Gold))

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## Liability (financial accounting)

In [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting), a **liability** is defined as an *obligation* of an entity arising from *past* transactions or events, the settlement of which may result in the transfer or use of [assets](http://en.wikipedia.org/wiki/Assets), provision of services or other yielding of economic benefits in the future. A liability is defined by the following characteristics:

* Any type of borrowing from persons or banks for improving a business or personal income that is payable during short or long time;
* A duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services, or other transaction yielding an economic benefit, at a specified or determinable date, on occurrence of a specified event, or on demand;
* A duty or responsibility that obligates the entity to another, leaving it little or no discretion to avoid settlement; and,
* A transaction or event obligating the entity that has already occurred.

Liabilities in financial accounting need not be legally enforceable; but can be based on equitable obligations or constructive obligations. An **equitable obligation** is a duty based on ethical or moral considerations. A **constructive obligation** is an obligation that is implied by a set of circumstances in a particular situation, as opposed to a contractually based obligation.

The [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation) relates [assets](http://en.wikipedia.org/wiki/Asset), liabilities, and [owner's equity](http://en.wikipedia.org/wiki/Ownership_equity):

 Assets = Liabilities + Owner's Equity 

The accounting equation is the mathematical structure of the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet).

The Australian Accounting Research Foundation [[1]](http://www.aarf.asn.au/) defines liabilities as: "future sacrifice of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions and other past events."

Probably the most accepted accounting definition of liability is the one used by the [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board) (IASB). The following is a quotation from IFRS Framework:

## Equity (finance)

In [accounting](http://en.wikipedia.org/wiki/Accountancy) and [finance](http://en.wikipedia.org/wiki/Finance), **equity** is the residual claim or interest of the most junior class of investors in [assets](http://en.wikipedia.org/wiki/Asset), after all [liabilities](http://en.wikipedia.org/wiki/Liabilities) are paid. If liability exceeds assets, [negative equity](http://en.wikipedia.org/wiki/Negative_equity) exists. In an accounting context, **Shareholders' equity** (or stockholders' equity, shareholders' funds, shareholders' capital or similar terms) represents the remaining interest in assets of a company, spread among individual [shareholders](http://en.wikipedia.org/wiki/Shareholder) of [common](http://en.wikipedia.org/wiki/Common_stock) or [preferred stock](http://en.wikipedia.org/wiki/Preferred_stock).

At the start of a [business](http://en.wikipedia.org/wiki/Business), [owners](http://en.wikipedia.org/wiki/Owner) put some funding into the business to finance [operations](http://en.wikipedia.org/wiki/Business_operations). This creates a liability on the business in the shape of [capital](http://en.wikipedia.org/wiki/Share_capital) as the business is a separate entity from its owners. Businesses can be considered, for [accounting](http://en.wikipedia.org/wiki/Accounting) purposes, sums of [liabilities](http://en.wikipedia.org/wiki/Liabilities) and [assets](http://en.wikipedia.org/wiki/Asset); this is the [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation). After liabilities have been accounted for the positive remainder is deemed the owner's interest in the business.

This definition is helpful in understanding the [liquidation](http://en.wikipedia.org/wiki/Liquidation) process in case of [bankruptcy](http://en.wikipedia.org/wiki/Bankruptcy). At first, all the secured [creditors](http://en.wikipedia.org/wiki/Creditor) are paid against proceeds from assets. Afterward, a series of creditors, ranked in priority sequence, have the next claim/right on the residual proceeds. Ownership equity is the last or [residual claim](http://en.wikipedia.org/wiki/Residual_claimant) against assets, paid only after all other creditors are paid. In such cases where even creditors could not get enough money to pay their bills, nothing is left over to reimburse owners' equity. Thus owners' equity is reduced to zero. Ownership equity is also known as risk capital or liable capital.

## Equity investments

An equity investment generally refers to the buying and holding of shares of [stock](http://en.wikipedia.org/wiki/Stock) on a [stock market](http://en.wikipedia.org/wiki/Stock_market) by individuals and firms in anticipation of income from [dividends](http://en.wikipedia.org/wiki/Dividend) and [capital gains](http://en.wikipedia.org/wiki/Capital_gain), as the value of the stock rises. Typically equity holders receive voting rights, meaning that they can vote on candidates for the board of directors (shown on a [proxy statement](http://en.wikipedia.org/wiki/Proxy_statement) received by the investor) as well as certain major transactions, and residual rights, meaning that they share the company's profits, as well as recover some of the company's assets in the event that it folds, although they generally have the lowest priority in recovering their investment. It may also refer to the acquisition of equity (ownership) participation in a private (unlisted) company or a [startup company](http://en.wikipedia.org/wiki/Startup_company). When the investment is in infant companies, it is referred to as [venture capital](http://en.wikipedia.org/wiki/Venture_capital) investing and is generally regarded as a higher risk than investment in listed going-concern situations.

The equities held by private individuals are often held as [mutual funds](http://en.wikipedia.org/wiki/Mutual_fund) or as other forms of [collective investment scheme](http://en.wikipedia.org/wiki/Collective_investment_scheme), many of which have quoted prices that are listed in financial newspapers or magazines; the mutual funds are typically managed by prominent fund management firms, such as [Schroders](http://en.wikipedia.org/wiki/Schroders), [Fidelity Investments](http://en.wikipedia.org/wiki/Fidelity_Investments) or [The Vanguard Group](http://en.wikipedia.org/wiki/The_Vanguard_Group). Such holdings allow individual investors to obtain the [diversification](http://en.wikipedia.org/wiki/Diversification_(finance)) of the fund(s) and to obtain the skill of the professional [fund managers](http://en.wikipedia.org/wiki/Fund_manager) in charge of the fund(s). An alternative, which is usually employed by large private investors and pension funds, is to hold shares directly; in the institutional environment many clients who own [portfolios](http://en.wikipedia.org/wiki/Portfolio_(finance)) have what are called [segregated funds](http://en.wikipedia.org/wiki/Segregated_fund), as opposed to or in addition to the pooled mutual fund alternatives.

A calculation can be made to assess whether an equity is over or underpriced, compared with a long-term government bond. This is called the [Yield Gap](http://en.wikipedia.org/wiki/Yield_Gap) or Yield Ratio. It is the ratio of the [dividend](http://en.wikipedia.org/wiki/Dividend) yield of an equity and that of the long-term bond.

## Revenue

In [business](http://en.wikipedia.org/wiki/Business), **revenue** is [income](http://en.wikipedia.org/wiki/Income) that a [company](http://en.wikipedia.org/wiki/Corporation) receives from its normal business activities, usually from the sale of [goods and services](http://en.wikipedia.org/wiki/Product_(business)) to customers. In many countries, such as the United Kingdom, revenue is referred to as **turnover**. Some companies receive revenue from [interest](http://en.wikipedia.org/wiki/Interest), [dividends](http://en.wikipedia.org/wiki/Dividend) or [royalties](http://en.wikipedia.org/wiki/Royalties) paid to them by other companies. Revenue may refer to business income in general, or it may refer to the amount, in a [monetary unit](http://en.wikipedia.org/wiki/Monetary_unit), received during a period of time, as in "Last year, Company X had revenue of $42 million." [Profits](http://en.wikipedia.org/wiki/Profit_(accounting)) or [net income](http://en.wikipedia.org/wiki/Net_income) generally imply total revenue minus total [expenses](http://en.wikipedia.org/wiki/Expense) in a given period. In [accounting](http://en.wikipedia.org/wiki/Accountancy), revenue is often referred to as the "top line" due to its position on the [income statement](http://en.wikipedia.org/wiki/Income_statement) at the very top. This is to be contrasted with the "bottom line" which denotes net income.

For [non-profit organizations](http://en.wikipedia.org/wiki/Non-profit_organization), annual revenue may be referred to as **gross receipts**. This revenue includes donations from individuals and corporations, support from government agencies, income from activities related to the organization's [mission](http://en.wikipedia.org/wiki/Mission_statement), and income from fundraising activities, membership dues, and financial investments such as [stock shares in companies](http://en.wikipedia.org/wiki/Stock).

In general usage, revenue is income received by an organization in the form of [cash](http://en.wikipedia.org/wiki/Cash) or cash equivalents. [Sales revenue](http://en.wikipedia.org/wiki/Sales_(accounting)) or revenues is income received from selling goods or services over a period of time. Tax is income that a government receives from taxpayers.

In more formal usage, revenue is a calculation or estimation of periodic income based on a particular [standard accounting practice](http://en.wikipedia.org/wiki/Standard_accounting_practice) or the rules established by a government or government agency. Two common [accounting methods](http://en.wikipedia.org/wiki/Accounting_methods), cash basis accounting and accrual basis accounting, do not use the same process for measuring revenue. Corporations that offer shares for sale to the public are usually required by law to report revenue based on [generally accepted accounting principles](http://en.wikipedia.org/wiki/Generally_accepted_accounting_principles) or [International Financial Reporting Standards](http://en.wikipedia.org/wiki/International_Financial_Reporting_Standards).

In a [double-entry bookkeeping system](http://en.wikipedia.org/wiki/Double-entry_bookkeeping_system), revenue accounts are [general ledger](http://en.wikipedia.org/wiki/General_ledger) accounts that are summarized periodically under the heading Revenue or Revenues on an income statement. Revenue account names describe the type of revenue, such as "Repair service revenue", "Rent revenue earned" or "Sales".

## Business revenue

Money income from activities that are ordinary for a particular corporation, company, partnership, or sole-proprietorship. For some businesses, such as [manufacturing](http://en.wikipedia.org/wiki/Manufacturing) and/or [grocery](http://en.wikipedia.org/wiki/Grocery), most revenue is from the sale of goods. Service businesses such as [law firms](http://en.wikipedia.org/wiki/Law_firm) and [barber shops](http://en.wikipedia.org/wiki/Barber) receive most of their revenue from rendering services. Lending businesses such as [car rentals](http://en.wikipedia.org/wiki/Car_rental) and [banks](http://en.wikipedia.org/wiki/Bank) receive most of their revenue from fees and interest generated by lending [assets](http://en.wikipedia.org/wiki/Asset) to other organizations or individuals.

Revenues from a business's primary activities are reported as **sales**, **sales revenue** or [**net sales**](http://en.wikipedia.org/wiki/Net_sales). This includes product returns and discounts for early payment of [invoices](http://en.wikipedia.org/wiki/Invoice). Most businesses also have revenue that is incidental to the business's primary activities, such as interest earned on deposits in a [demand account](http://en.wikipedia.org/wiki/Demand_account). This is included in revenue but not included in net sales.[[5]](http://en.wikipedia.org/wiki/Revenue#cite_note-4) Sales revenue does not include [sales tax](http://en.wikipedia.org/wiki/Sales_tax) collected by the business.

**Other revenue** (a.k.a. non-operating revenue) is revenue from peripheral (non-core) operations. For example, a company that manufactures and sells automobiles would record the revenue from the sale of an automobile as "regular" revenue. If that same company also rented a portion of one of its buildings, it would record that revenue as “other revenue” and disclose it separately on its income statement to show that it is from something other than its core operations.

### Financial statement analysis

Revenue is a crucial part of financial statement analysis. A company’s performance is measured to the extent to which its asset inflows (revenues) compare with its asset outflows ([expenses](http://en.wikipedia.org/wiki/Expenses)). [Net Income](http://en.wikipedia.org/wiki/Net_Income) is the result of this equation, but revenue typically enjoys equal attention during a standard [earnings call](http://en.wikipedia.org/wiki/Earnings_call). If a company displays solid “top-line growth,” analysts could view the period’s performance as positive even if earnings growth or “bottom-line growth” is stagnant. Conversely, high net income growth would be tainted if a company failed to produce significant revenue growth. Consistent revenue growth, as well as net income growth, is considered essential for a company's publicly traded [stock](http://en.wikipedia.org/wiki/Stock) to be attractive to investors.

Revenue is used as an indication of earnings quality. There are several [financial ratios](http://en.wikipedia.org/wiki/Financial_ratios) attached to it, the most important being [gross margin](http://en.wikipedia.org/wiki/Gross_margin) and [profit margin](http://en.wikipedia.org/wiki/Profit_margin). Also, companies use revenue to determine [bad debt expense](http://en.wikipedia.org/wiki/Bad_debt) using the income statement method.

Price / Sales is sometimes used as a substitute for a [Price to earnings ratio](http://en.wikipedia.org/wiki/P/E_ratio) when earnings are negative and the P/E is meaningless. Though a company may have negative earnings, it almost always has positive revenue.

[Gross Margin](http://en.wikipedia.org/wiki/Gross_Margin) is a calculation of revenue less [cost of goods sold](http://en.wikipedia.org/wiki/Cost_of_goods_sold), and is used to determine how well sales cover direct variable costs relating to the production of goods.

Net income/sales, or [profit margin](http://en.wikipedia.org/wiki/Profit_margin), is calculated by investors to determine how efficiently a company turns revenues into profits....

## Government revenue

Government revenue includes all amounts of money (i.e. taxes and/or fees) received from sources outside the government entity. Large governments usually have an [agency](http://en.wikipedia.org/wiki/Government_agency) or [department](http://en.wikipedia.org/wiki/Departmentalization) responsible for collecting government revenue from companies and individuals.[[6]](http://en.wikipedia.org/wiki/Revenue#cite_note-5)

Government revenue may also include [reserve bank](http://en.wikipedia.org/wiki/Reserve_bank) [currency](http://en.wikipedia.org/wiki/Currency) which is printed. This is recorded as an advance to the retail bank together with a corresponding currency in circulation expense entry. The income derives from the Official Cash rate payable by the retail banks for instruments such as 90 day bills. There is a question as to whether using generic business based accounting standards can give a fair and accurate picture of government accounts in that with a monetary policy statement to the reserve bank directing a positive inflation rate. The expense provision for the return of currency to the reserve bank is largely symbolic in that to totally cancel the currency in circulation provision all currency would have to be returned to the reserve bank and cancelled.

## Expense

In common usage, an **expense** or **expenditure** is an outflow of [money](http://en.wikipedia.org/wiki/Money) to another person or group to pay for an item or service, or for a category of costs. For a [tenant](http://en.wikipedia.org/wiki/Leasehold_estate), [rent](http://en.wikipedia.org/wiki/Renting) is an expense. For students or parents, [tuition](http://en.wikipedia.org/wiki/Tuition) is an expense. Buying food, clothing, furniture or an automobile is often referred to as an expense. An expense is a cost that is "paid" or "remitted", usually in exchange for something of value. Something that seems to cost a great deal is "expensive". Something that seems to cost little is "inexpensive". "Expenses of the table" are expenses of [dining](http://en.wikipedia.org/wiki/Dining), refreshments, a [feast](http://en.wikipedia.org/wiki/Banquet), etc.

In [accounting](http://en.wikipedia.org/wiki/Accounting), **expense** has a very specific meaning. It is an outflow of cash or other valuable assets from a person or company to another person or company. This outflow of cash is generally one side of a trade for products or services that have equal or better current or future value to the buyer than to the seller. Technically, an expense is an event in which an [asset](http://en.wikipedia.org/wiki/Asset) is used up or a [liability](http://en.wikipedia.org/wiki/Liability_(accounting)) is incurred. In terms of the [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation), expenses reduce owners' [equity](http://en.wikipedia.org/wiki/Equity_(economics)). The [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board) defines expenses as

*...decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.*[[1]](http://en.wikipedia.org/wiki/Expense#cite_note-0)

## Bookkeeping for expenses

In [double-entry bookkeeping](http://en.wikipedia.org/wiki/Double-entry_bookkeeping), expenses are recorded as a [debit](http://en.wikipedia.org/wiki/Debit) to an expense account (an [income statement](http://en.wikipedia.org/wiki/Income_statement) account) and a [credit](http://en.wikipedia.org/wiki/Credit) to either an asset account or a liability account, which are [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) accounts. An expense decreases assets or increases liabilities. Typical business expenses include salaries, utilities, depreciation of capital assets, and interest expense for loans. The purchase of a capital asset such as a building or equipment is not an expense.

## [[edit](http://en.wikipedia.org/w/index.php?title=Expense&action=edit&section=2)]Cash flow

In a [cash flow statement](http://en.wikipedia.org/wiki/Cash_flow_statement), expenditures are divided into operating, investing, and financing expenditures.

* [Operational expense](http://en.wikipedia.org/wiki/Operating_expense) – salary for employees
* [Capital expenditure](http://en.wikipedia.org/wiki/Capital_expenditure) – buying equipment
* [Financing expense](http://en.wikipedia.org/wiki/Corporate_finance) – [interest expense](http://en.wikipedia.org/wiki/Interest_expense) for [loans](http://en.wikipedia.org/wiki/Loans) and [bonds](http://en.wikipedia.org/wiki/Bond_(finance))

An important issue in [accounting](http://en.wikipedia.org/wiki/Accounting) is whether a particular expenditure is classified as an expense, which is reported immediately on the business's [income statement](http://en.wikipedia.org/wiki/Income_statement); or whether it is classified as a [capital expenditure](http://en.wikipedia.org/wiki/Capital_expenditure) or an expenditure subject to [depreciation](http://en.wikipedia.org/wiki/Depreciation), which is not an expense. These latter types of expenditures are reported as expenses when they are depreciated by businesses that use [accrual-basis accounting](http://en.wikipedia.org/wiki/Cash-basis_versus_accrual-basis_accounting), which is most large businesses and all [C corporations](http://en.wikipedia.org/wiki/C_corporation).

The most common interpretation of whether an expense is of capital or income variety depends upon its term. Viewing an expense as a purchase helps alleviate this distinction. If, soon after the "purchase", that which was expensed holds no value then it is usually identified as an expense. If it retains value soon and long after the purchase, it will be viewed as capital with life that should be [amortized](http://en.wikipedia.org/wiki/Amortized)/[depreciated](http://en.wikipedia.org/wiki/Depreciation) and retained on the [Balance Sheet](http://en.wikipedia.org/wiki/Balance_Sheet).

## Gain (finance)

In [finance](http://en.wikipedia.org/wiki/Finance), **gain** is a [profit](http://en.wikipedia.org/wiki/Profit_(accounting)) or an increase in value of an [investment](http://en.wikipedia.org/wiki/Investment) such as a [stock](http://en.wikipedia.org/wiki/Stock) or [bond](http://en.wikipedia.org/wiki/Bond_(finance)). Gain is calculated by [fair market value](http://en.wikipedia.org/wiki/Fair_market_value) or the proceeds from the sale of the investment minus the sum of the purchase price and all [costs](http://en.wikipedia.org/wiki/Cost) associated with it. If the investment is not converted into cash or another asset, the gain is then called an unrealized gain.

In accounting, a gain is a change in the value of an [asset](http://en.wikipedia.org/wiki/Asset) (increase) or [liability](http://en.wikipedia.org/wiki/Liability_(accounting)) (decrease) resulting from something other than the earnings process. While gains are often associated with investments, derivatives and other financial instruments, they can also result from something as simple as selling a production asset (such as a machine) for more than its net book (accounting) value.

As such, gains are similar to, but nonetheless significantly different from, revenues. The difference lies in the existence of intent to earn a profit. Thus, revenues result from the intentional producing and delivering of goods and/or rendering services, while gains can result from incidental occurrences and often-random events (such as the change in a stock’s market price, a gift or a chance discovery).

Finally, the term “realized” also has a slightly different meaning when used in the accounting context (the accounting context; that income/revenue should only be counted when realized, if unrealized the item should be counted as an asset [income receivable] on the Balance Sheet). Under US GAAP ([US Generally Accepted Accounting Principles](http://en.wikipedia.org/wiki/US_Generally_Accepted_Accounting_Principles)) or IFRS ([International Financial Reporting Standards](http://en.wikipedia.org/wiki/International_Financial_Reporting_Standards)), a gain is “realized” when the market value of some asset or liability (such as a financial instrument) changes, even if the reporting entity continues to hold that asset or liability.

## Cash flow statement

In [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting), a **cash flow statement**, also known as ***statement of cash flows*** or ***funds flow statement***,[[1]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-helfert-a-0) is a [financial statement](http://en.wikipedia.org/wiki/Financial_statements) that shows how changes in [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) accounts and income affect [cash and cash equivalents](http://en.wikipedia.org/wiki/Cash_and_cash_equivalents), and breaks the analysis down to operating, investing, and financing activities. Essentially, the cash flow statement is concerned with the flow of cash in and cash out of the business. The statement captures both the current operating results and the accompanying changes in the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet).[[1]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-helfert-a-0) As an analytical tool, the statement of cash flows is useful in determining the short-term viability of a company, particularly its ability to pay bills. International Accounting Standard 7 (IAS 7), is the [International Accounting Standard](http://en.wikipedia.org/wiki/International_Accounting_Standard) that deals with cash flow statements.

People and groups interested in cash flow statements include:

* Accounting personnel, who need to know whether the organization will be able to cover payroll and other immediate expenses
* Potential [lenders](http://en.wikipedia.org/wiki/Lender) or [creditors](http://en.wikipedia.org/wiki/Creditor), who want a clear picture of a company's ability to repay
* Potential [investors](http://en.wikipedia.org/wiki/Investor), who need to judge whether the company is financially sound
* Potential employees or contractors, who need to know whether the company will be able to afford compensation
* [Shareholders](http://en.wikipedia.org/wiki/Shareholder) of the business.

**Purpose**

The cash flow statement was previously known as the **flow of Cash statement**.[[2]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-1) The cash flow statement reflects a firm's liquidity.

The balance sheet is a snapshot of a firm's financial resources and obligations at a single point in time, and the income statement summarizes a firm's financial transactions over an interval of time. These two financial statements reflect the [accrual basis accounting](http://en.wikipedia.org/wiki/Accounting_methods#Accrual_basis) used by firms to match revenues with the expenses associated with generating those revenues. The cash flow statement includes only inflows and outflows of cash and cash equivalents; it excludes transactions that do not directly affect cash receipts and payments. These non-cash transactions include depreciation or write-offs on bad debts or credit losses to name a few.[[3]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-2) The cash flow statement is a [cash basis](http://en.wikipedia.org/wiki/Accounting_methods#Cash_basis) report on three types of financial activities: operating activities, investing activities, and financing activities. Non-cash activities are usually reported in footnotes.

The cash flow statement is intended to[[4]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-3)

1. provide information on a firm's [liquidity](http://en.wikipedia.org/wiki/Market_liquidity) and [solvency](http://en.wikipedia.org/wiki/Solvency) and its ability to change [cash flows](http://en.wikipedia.org/wiki/Cash_flow) in future circumstances
2. provide additional information for evaluating changes in assets, liabilities and equity
3. improve the comparability of different firms' operating performance by eliminating the effects of different [accounting methods](http://en.wikipedia.org/wiki/Accounting_methods)
4. indicate the amount, timing and probability of future cash flows

The cash flow statement has been adopted as a standard financial statement because it eliminates allocations, which might be derived from different accounting methods, such as various timeframes for depreciating fixed assets.[[5]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-Epstein.2C_p._91-4)

**Cash flow activities**

The cash flow statement is partitioned into three segments, namely: 1) cash flow resulting from operating activities; 2) cash flow resulting from investing activities; and 3) cash flow resulting from financing activities.

The money coming into the business is called cash inflow, and [money](http://en.wikipedia.org/wiki/Money) going out from the business is called cash outflow.

### Operating activities

Operating activities include the [production](http://en.wikipedia.org/wiki/Production,_costs,_and_pricing), [sales](http://en.wikipedia.org/wiki/Sales) and delivery of the company's product as well as collecting payment from its customers. This could include purchasing raw materials, building inventory, advertising, and shipping the product.

Under IAS 7, operating cash flows include:[[11]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-Epstein.2C_p._93-10)

* Receipts from the sale of goods or services
* Receipts for the sale of loans, debt or equity instruments in a trading portfolio
* Interest received on loans
* Payments to suppliers for goods and services.
* Payments to employees or on behalf of employees
* Interest payments (alternatively, this can be reported under financing activities in IAS 7, and US GAAP)
* buying Merchandise

Items which are added back to [or subtracted from, as appropriate] the net income figure (which is found on the Income Statement) to arrive at cash flows from operations generally include:

* [Depreciation](http://en.wikipedia.org/wiki/Depreciation) (loss of tangible asset value over time)
* [Deferred tax](http://en.wikipedia.org/wiki/Deferred_tax)
* [Amortization](http://en.wikipedia.org/wiki/Amortization_(business)#Accounting) (loss of intangible asset value over time)
* Any gains or losses associated with the sale of a non-current asset, because associated cash flows do not belong in the operating section.(unrealized gains/losses are also added back from the income statement)

### Investing activities

Examples of investing activities are

* Purchase or Sale of an asset (assets can be land, building, equipment, marketable securities, etc.)
* Loans made to suppliers or received from customers
* Payments related to mergers and acquisitions.

### Financing activities

Financing activities include the inflow of cash from [investors](http://en.wikipedia.org/wiki/Investor) such as [banks](http://en.wikipedia.org/wiki/Bank) and [shareholders](http://en.wikipedia.org/wiki/Shareholder), as well as the outflow of cash to shareholders as [dividends](http://en.wikipedia.org/wiki/Dividend) as the company generates income. Other activities which impact the long-term liabilities and equity of the company are also listed in the financing activities section of the cash flow statement.

Under IAS 7,

* Proceeds from issuing short-term or long-term debt
* Payments of dividends
* Payments for repurchase of company shares
* Repayment of debt principal, including capital leases
* For non-profit organizations, receipts of donor-restricted cash that is limited to long-term purposes

Items under the financing activities section include:

* [Dividends](http://en.wikipedia.org/wiki/Dividends) paid
* Sale or repurchase of the company's [stock](http://en.wikipedia.org/wiki/Stock)
* Net [borrowings](http://en.wikipedia.org/wiki/Debt)
* Payment of dividend tax

**Disclosure of non-cash activities**

Under IAS 7, non-cash investing and financing activities are disclosed in footnotes to the financial statements. Under US General Accepted Accounting Principles (GAAP), non-cash activities may be disclosed in a footnote or within the cash flow statement itself. Non-cash financing activities may include[[11]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-Epstein.2C_p._93-10)

* Leasing to purchase an asset
* Converting debt to equity
* Exchanging non-cash assets or liabilities for other non-cash assets or liabilities
* Issuing shares in exchange for assets

**Preparation methods**

The direct method of preparing a cash flow statement results in a more easily understood report.[[12]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-11) The indirect method is almost universally used, because FAS 95 requires a supplementary report similar to the indirect method if a company chooses to use the direct method.

[[edit](http://en.wikipedia.org/w/index.php?title=Cash_flow_statement&action=edit&section=9)]Direct method

The direct method for creating a cash flow statement reports major classes of gross cash receipts and payments. Under IAS 7, dividends received may be reported under operating activities or under investing activities. If taxes paid are directly linked to operating activities, they are reported under operating activities; if the taxes are directly linked to investing activities or financing activities, they are reported under investing or financing activities.

**Sample cash flow statement using the direct method**

|  |  |  |
| --- | --- | --- |
| **Cash flows from (used in) operating activities** | | |
| **Cash receipts from customers** | **9,500** |  |
| **Cash paid to suppliers and employees** | **(2,000)** |  |
| **Cash generated from operations (sum)** | **7,500** |  |
| **Interest paid** | **(2,000)** |  |
| **Income taxes paid** | **(3,000)** |  |
| **Net cash flows from operating activities** |  | **2,500** |
| **Cash flows from (used in) investing activities** | | |
| **Proceeds from the sale of equipment** | **7,500** |  |
| **Dividends received** | **3,000** |  |
| **Net cash flows from investing activities** |  | **10,500** |
| **Cash flows from (used in) financing activities** | | |
| **Dividends paid** | **(2,500)** |  |
| **Net cash flows used in financing activities** |  | **(2,500)** |
| **.** | | |
| **Net increase in cash and cash equivalents** |  | **10,500** |
| **Cash and cash equivalents, beginning of year** |  | **1,000** |
| **Cash and cash equivalents, end of year** |  | **$11,500** |

### Indirect method

The indirect method uses net-income as a starting point, makes adjustments for all transactions for non-cash items, then adjusts from all cash-based transactions. An increase in an asset account is subtracted from net income, and an increase in a liability account is added back to net income. This method converts accrual-basis net income (or loss) into cash flow by using a series of additions and deductions.[[14]](http://en.wikipedia.org/wiki/Cash_flow_statement#cite_note-13)

#### Rules (operating activities)

The following rules can be followed to calculate Cash Flows from Operating Activities when given only a two year comparative balance sheet and the Net Income figure. Cash Flows from Operating Activities can be found by adjusting Net Income relative to the change in beginning and ending balances of Current Assets, Current Liabilities, and sometimes Long Term Assets. When comparing the change in long term assets over a year, the accountant must be certain that these changes were caused entirely by their devaluation rather than purchases or sales (i.e. they must be operating items not providing or using cash) or if they are no operating items

* Decrease in non-cash current assets are added to net income
* Increase in non-cash current asset are subtracted from net income
* Increase in current liabilities are added to net income
* Decrease in current liabilities are subtracted from net income
* Expenses with no cash outflows are added back to net income (depreciation and/or amortization expense are the only operating items that have no effect on cash flows in the period)
* Revenues with no cash inflows are subtracted from net income
* Non operating losses are added back to net income
* Non operating gains are subtracted from net income

The intricacies of this procedure might be seen as,

Net\ Cash\ Flows\ from\ Operating\ Activities\ = Net\ Income\ + Rule\ Items\,

For example, consider a company that has a net income of $100 this year, and its A/R increased by $25 since the beginning of the year. If the balances of all other current assets, long term assets and current liabilities did not change over the year, the cash flows could be determined by the rules above as $100 – $25 = Cash Flows from Operating Activities = $75. The logic is that, if the company made $100 that year (net income), and they are using the accrual accounting system (not cash based) then any income they generated that year which has not yet been paid for in cash should be subtracted from the net income figure in order to find cash flows from operating activities. And the increases in A/R meant that $25 of sales occurred on credit and have not yet been paid for in cash.

In the case of finding Cash Flows when there is a change in a fixed asset account, say the Buildings and Equipment account decreases, the change is added back to Net Income. The reasoning behind this is that because Net Income is calculated by, Net Income = Rev - Cogs - Depreciation Exp - Other Exp then the Net Income figure will be decreased by the building's depreciation that year. This depreciation is not associated with an exchange of cash, therefore the depreciation is added back into net income to remove the non-cash activity.

#### Rules (financing activities)

Finding the Cash Flows from Financing Activities is much more intuitive and needs little explanation. Generally, the things to account for are financing activities:

* Include as outflows, reductions of long term notes payable (as would represent the cash repayment of debt on the balance sheet)
* Or as inflows, the issuance of new notes payable
* Include as outflows, all dividends paid by the entity to outside parties
* Or as inflows, dividend payments received from outside parties
* Include as outflows, the purchase of notes stocks or bonds
* Or as inflows, the receipt of payments on such financing vehicles.

In the case of more advanced accounting situations, such as when dealing with subsidiaries, the accountant must

* Exclude intra-company dividend payments.
* Exclude intra-company bond interest.

A traditional equation for this might look something like,

**Example: cash flow of XYZ**:

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ co. Ltd. Cash Flow Statement  (all numbers in millions of Rs.)** | | | |
| ***Period ending*** | ***03/31/2010*** | ***03/31/2009*** | ***03/31/2008*** |
| **Net income** | **21,538** | **24,589** | **17,046** |
| **Operating activities, cash flows provided by or used in:** | | | |
| **Depreciation and amortization** | **2,790** | **2,592** | **2,747** |
| **Adjustments to net income** | **4,617** | **621** | **2,910** |
| **Decrease (increase) in accounts receivable** | **12,503** | **17,236** | **--** |
| **Increase (decrease) in liabilities (A/P, taxes payable)** | **131,622** | **19,822** | **37,856** |
| **Decrease (increase) in inventories** | **--** | **--** | **--** |
| **Increase (decrease) in other operating activities** | **(173,057)** | **(33,061)** | **(62,963)** |
| **Net cash flow from operating activities** | **13** | **31,799** | **(2,404)** |
| **Investing activities, cash flows provided by or used in:** | | | |
| **Capital expenditures** | **(4,035)** | **(3,724)** | **(3,011)** |
| **Investments** | **(201,777)** | **(71,710)** | **(75,649)** |
| **Other cash flows from investing activities** | **1,606** | **17,009** | **(571)** |
| **Net cash flows from investing activities** | **(204,206)** | **(58,425)** | **(79,231)** |
| **Financing activities, cash flows provided by or used in:** | | | |
| **Dividends paid** | **(9,826)** | **(9,188)** | **(8,375)** |
| **Sale (repurchase) of stock** | **(5,327)** | **(12,090)** | **133** |
| **Increase (decrease) in debt** | **101,122** | **26,651** | **21,204** |
| **Other cash flows from financing activities** | **120,461** | **27,910** | **70,349** |
| **Net cash flows from financing activities** | **206,430** | **33,283** | **83,311** |
| **Effect of exchange rate changes** | **645** | **(1,840)** | **731** |
| **Net increase (decrease) in cash and cash equivalents** | **2,882** | **4,817** | **2,407** |

## Income statement

**Income statement** (also referred to as ***profit and loss statement (P&L)***, ***revenue statement***, ***statement of financial performance***, ***earnings statement***, ***operating statement*** or ***statement of operations***)[[1]](http://en.wikipedia.org/wiki/Income_statement#cite_note-helfert-a-0) is a company's [financial statement](http://en.wikipedia.org/wiki/Financial_statement) that indicates how the [revenue](http://en.wikipedia.org/wiki/Revenue) (money received from the sale of products and services before expenses are taken out, also known as the "top line") is transformed into the [net income](http://en.wikipedia.org/wiki/Net_income) (the result after all revenues and expenses have been accounted for, also known as Net Profit or the "bottom line"). It displays the revenues recognized for a specific period, and the [cost](http://en.wikipedia.org/wiki/Cost) and [expenses](http://en.wikipedia.org/wiki/Expense) charged against these revenues, including [write-offs](http://en.wikipedia.org/wiki/Write-off) (e.g., [depreciation](http://en.wikipedia.org/wiki/Depreciation) and [amortization](http://en.wikipedia.org/wiki/Amortization) of various [assets](http://en.wikipedia.org/wiki/Asset)) and [taxes](http://en.wikipedia.org/wiki/Tax).[[1]](http://en.wikipedia.org/wiki/Income_statement#cite_note-helfert-a-0) The purpose of the income statement is to show [managers](http://en.wikipedia.org/wiki/Management) and [investors](http://en.wikipedia.org/wiki/Investor) whether the company made or lost money during the period being reported.

The important thing to remember about an income statement is that it represents a period of time. This contrasts with the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet), which represents a single moment in time.

[Charitable organizations](http://en.wikipedia.org/wiki/Charitable_organizations) that are required to publish financial statements do not produce an income statement. Instead, they produce a similar statement that reflects funding sources compared against program expenses, administrative costs, and other operating commitments. This statement is commonly referred to as the [statement of activities](http://www.1800net.com/nprc/fasb117.html#2). Revenues and expenses are further categorized in the statement of activities by the donor restrictions on the funds received and expended.

The income statement can be prepared in one of two methods.[[2]](http://en.wikipedia.org/wiki/Income_statement#cite_note-1) The Single Step income statement takes a simpler approach, totaling revenues and subtracting expenses to find the bottom line. The more complex Multi-Step income statement (as the name implies) takes several steps to find the bottom line, starting with the [gross profit](http://en.wikipedia.org/wiki/Gross_profit). It then calculates [operating expenses](http://en.wikipedia.org/wiki/Operating_expenses) and, when deducted from the gross profit, yields income from operations. Adding to income from operations is the difference of other revenues and other expenses. When combined with income from operations, this yields income before taxes. The final step is to deduct taxes, which finally produces the net income for the period measured.

## Usefulness and limitations of income statement

Income statements should help investors and creditors determine the past financial performance of the enterprise, predict future performance, and assess the capability of generating future cash flows through report of the income and expenses.

However, information of an income statement has several limitations:

* Items that might be relevant but cannot be reliably measured are not reported (*e.g.* brand recognition and loyalty).
* Some numbers depend on accounting methods used (*e.g.* using [FIFO or LIFO accounting](http://en.wikipedia.org/wiki/FIFO_and_LIFO_accounting) to measure [inventory](http://en.wikipedia.org/wiki/Inventory#Accounting_for_inventory) level).
* Some numbers depend on judgments and estimates (*e.g.* [depreciation](http://en.wikipedia.org/wiki/Depreciation) expense depends on estimated useful life and salvage value).

- INCOME STATEMENT GREENHARBOR LLC -

For the year ended DECEMBER 31 2010

€ €

Debit Credit

Revenues

GROSS REVENUES (including INTEREST income) 296,397

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Expenses:

ADVERTISING 6,300

BANK & CREDIT CARD FEES 144

BOOKKEEPING 2,350

SUBCONTRACTORS 88,000

ENTERTAINMENT 5,550

INSURANCE 750

LEGAL & PROFESSIONAL SERVICES 1,575

LICENSES 632

PRINTING, POSTAGE & STATIONERY 320

RENT 13,000

MATERIALS 74,400

TELEPHONE 1,000

UTILITIES 1,491

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TOTAL EXPENSES (195,512)

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NET INCOME 100,885

Guidelines for statements of comprehensive income and income statements of business entities are formulated by the [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board) and numerous country-specific organizations, for example the [FASB](http://en.wikipedia.org/wiki/FASB) in the U.S.

Names and usage of different accounts in the income statement depend on the type of organization, industry practices and the requirements of different jurisdictions.

If applicable to the business, summary values for the following items should be included in the income statement:

### Operating section

* [**Revenue**](http://en.wikipedia.org/wiki/Revenue) - Cash inflows or other enhancements of assets of an entity during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major operations. It is usually presented as sales minus sales discounts, returns, and allowances. Every time a business sells a product or performs a service, it obtains revenue. This often is referred to as gross revenue or sales revenue. [[4]](http://en.wikipedia.org/wiki/Income_statement#cite_note-3)
* [**Expenses**](http://en.wikipedia.org/wiki/Expenses) - Cash outflows or other using-up of assets or incurrence of liabilities during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major operations.
  + [**Cost of Goods Sold**](http://en.wikipedia.org/wiki/Cost_of_Goods_Sold)**(COGS) /**[**Cost of Sales**](http://en.wikipedia.org/wiki/Cost_of_Sales) - represents the direct costs attributable to goods produced and sold by a business (manufacturing or merchandizing). It includes *material costs*, *direct labour*, and *overhead costs* (as in [absorption costing](http://en.wikipedia.org/wiki/Absorption_costing)), and excludes operating costs (period costs) such as selling, administrative, advertising or R&D, etc.
  + **Selling, General and Administrative expenses (**[**SG&A**](http://en.wikipedia.org/wiki/SG%26A)**or SGA)** - consist of the combined payroll costs. SGA is usually understood as a major portion of non-production related costs, in contrast to production costs such as direct labour.
    - **Selling expenses** - represent expenses needed to sell products (e.g. *salaries of sales people, commissions and travel expenses, advertising, freight, shipping, depreciation of sales store buildings and equipment*, etc.).
    - **General and Administrative (G&A) expenses** - represent expenses to manage the business (*salaries of officers / executives, legal and professional fees, utilities, insurance, depreciation of office building and equipment, office rents, office supplies*, etc.).
  + [**Depreciation**](http://en.wikipedia.org/wiki/Depreciation)**/**[**Amortization**](http://en.wikipedia.org/wiki/Amortization) - the charge with respect to [fixed assets](http://en.wikipedia.org/wiki/Fixed_assets) / [intangible assets](http://en.wikipedia.org/wiki/Intangible_assets) that have been capitalized on the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) for a specific (accounting) period. It is a systematic and rational allocation of cost rather than the recognition of market value decrement.
  + **Research & Development (R&D) expenses** - represent expenses included in research and development.

*Expenses* recognised in the income statement should be analyzed either by **nature** (raw materials, transport costs, staffing costs, depreciation, employee benefit etc.) or by **function** (cost of sales, selling, administrative, etc.). (IAS 1.99) If an entity categorizes by function, then additional information on the nature of expenses, at least, – depreciation, amortization and employee benefits expense – must be disclosed. (IAS 1.104) The major exclusive of costs of goods sold, are classified as operating expenses. These represent the resources expended, except for inventory purchases, in generating the revenue for the period. Expenses often are divided into two broad sub classifications selling expenses and administrative expenses.

### Non-operating section

* **Other revenues or gains** - revenues and gains from other than primary business activities (e.g. *rent*, *income from patents*). It also includes unusual gains that are either unusual or infrequent, but not both (e.g. *gain from sale of securities* or *gain from disposal of fixed assets*)
* **Other expenses or losses** - expenses or losses not related to primary business operations, (e.g. *foreign exchange loss*).
* **Finance costs** - costs of borrowing from various creditors (e.g. [*interest expenses*](http://en.wikipedia.org/wiki/Interest_expense), *bank charges*).
* **Income tax expense** - sum of the amount of [tax](http://en.wikipedia.org/wiki/Tax) payable to tax authorities in the current reporting period (current tax liabilities/ tax payable) and the amount of [deferred tax](http://en.wikipedia.org/wiki/Deferred_tax) liabilities (or assets).

### Irregular items

They are reported separately because this way users can better predict future cash flows - irregular items most likely will not recur. These are reported ***net of taxes***.

* [**Discontinued operations**](http://en.wikipedia.org/wiki/Discontinued_operation) is the most common type of irregular items. Shifting business location(s), stopping production temporarily, or changes due to technological improvement do **not** qualify as discontinued operations. Discontinued operations *must* be shown separately.

**Cumulative effect of changes in accounting policies (principles)** is the difference between the book value of the affected assets (or liabilities) under the old policy (principle) and what the book value would have been if the new principle had been applied in the prior periods. For example, valuation of inventories using [LIFO](http://en.wikipedia.org/wiki/FIFO_and_LIFO_accounting) instead of [weighted average method](http://en.wikipedia.org/wiki/Average_costing). The changes should be applied **retrospectively** and shown as adjustments to the *beginning* balance of affected components in [Equity](http://en.wikipedia.org/wiki/Equity_(finance)). All comparative financial statements should be restated. (IAS 8)

However, ***changes in estimates*** (e.g. estimated useful life of a fixed asset) only requires **prospective** changes. (IAS 8)

**No** items may be presented in the income statement as **extraordinary items**. (IAS 1.87) *Extraordinary items* are both unusual (abnormal) and infrequent, for example, unexpected natural disaster, expropriation, prohibitions under new regulations. [Note: natural disaster might not qualify depending on location (e.g. frost damage would not qualify in Canada but would in the tropics).]

Additional items may be needed to fairly present the entity's results of operations. (IAS 1.85)

### Disclosures

Certain items must be disclosed separately in the notes (or the [statement of comprehensive income](http://en.wikipedia.org/wiki/Statement_of_comprehensive_income)), if material, including:[[3]](http://en.wikipedia.org/wiki/Income_statement#cite_note-iasplus.com-2) (IAS 1.98)

* Write-downs of [inventories](http://en.wikipedia.org/wiki/Inventories) to net realizable value or of [property, plant and equipment](http://en.wikipedia.org/wiki/Property,_plant_and_equipment) to recoverable amount, as well as *reversals* of such write-downs
* Restructurings of the activities of an entity and *reversals* of any provisions for the costs of restructuring
* Disposals of items of property, plant and equipment
* Disposals of investments
* [Discontinued operations](http://en.wikipedia.org/wiki/Discontinued_operations)
* Litigation settlements
* Other reversals of provisions

### Earnings per share

Because of its importance, [earnings per share](http://en.wikipedia.org/wiki/Earnings_per_share) (EPS) are required to be disclosed on the face of the income statement. A company which reports any of the irregular items must also report EPS for these items either in the statement or in the notes.

\text{Earnings per share} = \frac{\text{Net income} - \text{Preferred stock dividends}}{\text{Weighted average of common stock shares outstanding}}

There are two forms of EPS reported:

* **Basic**: in this case "weighted average of shares outstanding" includes only actual stocks outstanding.
* **Diluted**: in this case "weighted average of shares outstanding" is calculated as if all stock options, warrants, convertible bonds, and other securities that could be transformed into shares *are* transformed. This increases the number of shares and so EPS decreases. **Diluted EPS is considered to be a more reliable way to measure EPS.**

## Sample income statement

The following income statement is a very brief example prepared in accordance with [IFRS](http://en.wikipedia.org/wiki/IFRS). It does not show all possible kinds of items appeared a firm, but it shows the most usual ones. Please note the difference between [IFRS](http://en.wikipedia.org/wiki/IFRS) and [US GAAP](http://en.wikipedia.org/wiki/US_GAAP) when interpreting the following sample income statements.

Fitness Equipment Limited

INCOME STATEMENTS

(in millions)

Year Ended March 31, 2009 2008 2007

----------------------------------------------------------------------------------

Revenue $ 14,580.2 $ 11,900.4 $ 8,290.3

Cost of sales (6,740.2) (5,650.1) (4,524.2)

------------- ------------ ------------

*Gross profit 7,840.0 6,250.3 3,766.1*

------------- ------------ ------------

SGA expenses (3,624.6) (3,296.3) (3,034.0)

------------- ------------ ------------

***Operating profit $ 4,215.4 $ 2,954.0 $ 732.1***

------------- ------------ ------------

Gains from disposal of fixed assets 46.3 - -

Interest expense (119.7) (124.1) (142.8)

------------- ------------ ------------

Profit *before* tax 4,142.0 2,829.9 589.3

------------- ------------ ------------

Income tax expense (1,656.8) (1,132.0) (235.7)

------------- ------------ ------------

***Profit (or loss) for the year $ 2,485.2 $ 1,697.9 $ 353.6***

DEXTERITY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions)

Year Ended December 31, 2009 2008 2007

----------------------------------------------------------------------------------------------

[Revenue](http://en.wikipedia.org/wiki/Revenue) $ 36,525.9 $ 29,827.6 $ 21,186.8

[Cost of sales](http://en.wikipedia.org/wiki/Cost_of_sales) (18,545.8) (15,858.8) (11,745.5)

----------- ----------- ------------

[*Gross profit*](http://en.wikipedia.org/wiki/Gross_profit) *17,980.1 13,968.8 9,441.3*

----------- ----------- ------------

Operating expenses:

[Selling, general and administrative expenses](http://en.wikipedia.org/wiki/SG%26A) (4,142.1) (3,732.3) (3,498.6)

[Depreciation](http://en.wikipedia.org/wiki/Depreciation) (602.4) (584.5) (562.3)

[Amortization](http://en.wikipedia.org/wiki/Amortization) (209.9) (141.9) (111.8)

[Impairment loss](http://en.wikipedia.org/wiki/Impaired_asset) (17,997.1) — —

----------- ----------- ------------

Total operating expenses (22,951.5) (4,458.7) (4,172.7)

----------- ----------- ------------

***Operating profit (or loss) $ (4,971.4) $ 9,510.1 $ 5,268.6***

----------- ----------- ------------

Interest income 25.3 11.7 12.0

Interest expense (718.9) (742.9) (799.1)

----------- ----------- ------------

Profit (or loss) from continuing operations

*before* tax, share of profit (or loss) from

Associates and non-controlling interest $ (5,665.0) $ 8,778.9 $ 4,481.5

----------- ----------- ------------

Income [tax](http://en.wikipedia.org/wiki/Tax) expense (1,678.6) (3,510.5) (1,789.9)

Profit (or loss) from [associates](http://en.wikipedia.org/wiki/Associate_company), *net of tax* (20.8) 0.1 (37.3)

Profit (or loss) from [non-controlling interest](http://en.wikipedia.org/wiki/Non-controlling_interest),

*net of tax* (5.1) (4.7) (3.3)

----------- ----------- ------------

**Profit (or loss) from continuing operations $ (7,348.7) $ 5,263.8 $ 2,651.0**

----------- ----------- ------------

Profit (or loss) from [discontinued operations](http://en.wikipedia.org/wiki/Discontinued_operations),

*net of tax* (1,090.3) (802.4) 164.6

----------- ----------- ------------

***Profit (or loss) for the year $ (8,439.0) $ 4,461.4 $ 2,815.6***

## Bottom line

"Bottom line" is the [net income](http://en.wikipedia.org/wiki/Net_income) that is calculated after subtracting the expenses from revenue. Since this forms the last line of the income statement, it is informally called "bottom line." It is important to investors as it represents the profit for the year attributable to the shareholders.

After revision to IAS 1 in 2003, the Standard is now using **profit or loss for the year** rather than *net profit or loss* or *net income* as the descriptive term for the bottom line of the income statement.

## Requirements of IFRS

On 6 September 2007, the [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board) issued a revised *IAS 1: Presentation of Financial Statements*, which is effective for annual periods beginning on or after 1 January 2009.

A business entity adopting IFRS must include:

* a [**Statement of Comprehensive Income**](http://en.wikipedia.org/wiki/Statement_of_Comprehensive_Income) or
* *two* separate statements comprising:

1. an ***Income Statement*** displaying components of profit or loss **and**
2. a *Statement of Comprehensive Income* that *begins* with profit or loss (bottom line of the income statement) and displays the items of [other comprehensive income](http://en.wikipedia.org/wiki/Other_comprehensive_income) for the reporting period. (IAS1.81)

All non-owner changes in equity (i.e. *comprehensive income* ) shall be presented in either in the statement of comprehensive income (or in a separate income statement and a statement of comprehensive income). Components of comprehensive income may not be presented in the [statement of changes in equity](http://en.wikipedia.org/wiki/Statement_of_changes_in_equity).

[*Comprehensive income*](http://en.wikipedia.org/wiki/Comprehensive_income) for a period includes profit or loss (net income) for that period and [other comprehensive income](http://en.wikipedia.org/wiki/Other_comprehensive_income) recognised in that period.

All items of income and expense recognised in a period must be included in profit or loss unless a Standard or an Interpretation requires otherwise. (IAS 1.88) Some IFRSs require or permit that some components to be excluded from profit or loss and instead to be included in other comprehensive income. (IAS 1.89)

### Items and disclosures

The **statement of comprehensive income** should include: (IAS 1.82)

1. [Revenue](http://en.wikipedia.org/wiki/Revenue)
2. Finance costs (including [interest expenses](http://en.wikipedia.org/wiki/Interest_expense))
3. Share of the profit or loss of [associates](http://en.wikipedia.org/wiki/Associate_company) and [joint ventures](http://en.wikipedia.org/wiki/Joint_ventures) accounted for using the [equity method](http://en.wikipedia.org/wiki/Equity_method)
4. [Tax](http://en.wikipedia.org/wiki/Tax) expense
5. A *single* amount comprising the total of (1) the *post-tax* profit or loss of [*discontinued operations*](http://en.wikipedia.org/wiki/Discontinued_operations) and (2) the *post-tax* gain or loss recognised on the disposal of the assets or disposal group(s) constituting the *discontinued operation*
6. Profit or loss
7. Each component of [other comprehensive income](http://en.wikipedia.org/wiki/Other_comprehensive_income) classified by nature
8. Share of the other comprehensive income of associates and joint ventures accounted for using the equity method
9. [Total comprehensive income](http://en.wikipedia.org/wiki/Total_comprehensive_income)

The following items must also be disclosed in the statement of comprehensive income as allocations for the period: (IAS 1.83)

* Profit or loss for the period attributable to [non-controlling interests](http://en.wikipedia.org/wiki/Non-controlling_interest) and owners of the [parent](http://en.wikipedia.org/wiki/Parent_company)
* Total comprehensive income attributable to non-controlling interests and owners of the parent

*No* items may be presented in the statement of comprehensive income (or in the income statement, if separately presented) or in the notes as *extraordinary items*.

## Balance sheet

In [financial accounting](http://en.wikipedia.org/wiki/Financial_accounting), a balance sheet or statement of financial position is a summary of the financial balances of a [sole proprietorship](http://en.wikipedia.org/wiki/Sole_proprietorship), a [business partnership](http://en.wikipedia.org/wiki/Partnership), a [corporation](http://en.wikipedia.org/wiki/Corporation) or other business organization, such as an [LLC](http://en.wikipedia.org/wiki/Limited_liability_company) or an [LLP](http://en.wikipedia.org/wiki/LLP). [Assets](http://en.wikipedia.org/wiki/Asset), [liabilities](http://en.wikipedia.org/wiki/Liability_(financial_accounting)) and [ownership equity](http://en.wikipedia.org/wiki/Ownership_equity) are listed as of a specific date, such as the end of its [financial year](http://en.wikipedia.org/wiki/Financial_year). A balance sheet is often described as a "snapshot of a company's financial condition".[[1]](http://en.wikipedia.org/wiki/Balance_Sheet#cite_note-0) Of the four basic [financial statements](http://en.wikipedia.org/wiki/Financial_statements), the balance sheet is the only statement which applies to a single point in time of a business' calendar year.

A standard company balance sheet has three parts: assets, liabilities and ownership equity. The main categories of assets are usually listed first, and typically in order of [liquidity](http://en.wikipedia.org/wiki/Liquidity).[[2]](http://en.wikipedia.org/wiki/Balance_Sheet#cite_note-1) Assets are followed by the liabilities. The difference between the assets and the liabilities is known as equity or the [net assets](http://en.wikipedia.org/wiki/Net_assets) or the [net worth](http://en.wikipedia.org/wiki/Net_worth) or capital of the company and according to the [accounting equation](http://en.wikipedia.org/wiki/Accounting_equation), net worth must equal assets minus liabilities.

Another way to look at the same equation is that assets equal liabilities plus owner's equity. Looking at the equation in this way shows how assets were financed: either by borrowing money (liability) or by using the owner's money (owner's equity). Balance sheets are usually presented with assets in one section and liabilities and net worth in the other section with the two sections "balancing."

A business operating entirely in cash can measure its profits by withdrawing the entire bank balance at the end of the period, plus any cash in hand. However, many businesses are not paid immediately; they build up inventories of goods and they acquire buildings and equipment. In other words: businesses have [assets](http://en.wikipedia.org/wiki/Asset) and so they cannot, even if they want to, immediately turn these into cash at the end of each period. Often, these businesses owe money to suppliers and to tax authorities, and the proprietors do not withdraw all their original capital and profits at the end of each period. In other words businesses also have [liabilities](http://en.wikipedia.org/wiki/Liability_(financial_accounting)).

Types

A balance sheet summarizes an organization or individual's assets, equity and liabilities at a specific point in time. Individuals and small businesses tend to have simple balance sheets. Larger businesses tend to have more complex balance sheets, and these are presented in the organization's [annual report](http://en.wikipedia.org/wiki/Annual_report). Large businesses also may prepare balance sheets for segments of their businesses.[[6]](http://en.wikipedia.org/wiki/Balance_Sheet#cite_note-5) A balance sheet is often presented alongside one for a different point in time (typically the previous year) for comparison.

Personal balance sheet

A personal balance sheet lists current assets such as cash in [checking accounts](http://en.wikipedia.org/wiki/Checking_account) and [savings accounts](http://en.wikipedia.org/wiki/Savings_account), long-term assets such as [common stock](http://en.wikipedia.org/wiki/Common_stock) and [real estate](http://en.wikipedia.org/wiki/Real_estate), current liabilities such as [loan](http://en.wikipedia.org/wiki/Loan) debt and [mortgage](http://en.wikipedia.org/wiki/Mortgage_loan) debt due, or overdue, long-term liabilities such as [mortgage](http://en.wikipedia.org/wiki/Mortgage) and other loan debt. Securities and real estate values are listed at [market value](http://en.wikipedia.org/wiki/Market_value) rather than at [historical cost](http://en.wikipedia.org/wiki/Historical_cost) or [cost basis](http://en.wikipedia.org/wiki/Cost_basis). Personal [net worth](http://en.wikipedia.org/wiki/Net_worth) is the difference between an individual's total assets and total liabilities.

US small business balance sheet

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Sample Small Business Balance Sheet | | | | |
| Assets | | Liabilities and Owners' Equity | | |
| Cash | $6,600 | Liabilities | | |
| Accounts Receivable | $6,200 | Notes Payable | $30,000 |  |
| Tools and equipment | $25,000 | Accounts Payable | | |
|  | | *Total liabilities* | | $30,000 |
|  | | Owners' equity | | |
|  | | Capital Stock | $7,000 |  |
|  | | Retained Earnings | $800 |  |
|  | | *Total owners' equity* | | $7,800 |
| *Total* | $37,800 | *Total* | | $37,800 |
|  |  |  | |  |

A small business balance sheet lists current assets such as cash, [accounts receivable](http://en.wikipedia.org/wiki/Accounts_receivable), and [inventory](http://en.wikipedia.org/wiki/Inventory), fixed assets such as land, buildings, and equipment, [intangible assets](http://en.wikipedia.org/wiki/Intangible_asset) such as [patents](http://en.wikipedia.org/wiki/Patent), and liabilities such as [accounts payable](http://en.wikipedia.org/wiki/Accounts_payable), accrued expenses, and long-term debt. [Contingent liabilities](http://en.wikipedia.org/wiki/Contingent_liabilities) such as [warranties](http://en.wikipedia.org/wiki/Warranties) are noted in the footnotes to the balance sheet. The small business's equity is the difference between total assets and total liabilities.

## Public Business Entities balance sheet structure

Guidelines for balance sheets of public business entities are given by the [International Accounting Standards Committee](http://en.wikipedia.org/wiki/International_Accounting_Standards_Committee) (now [International Accounting Standards Board](http://en.wikipedia.org/wiki/International_Accounting_Standards_Board)) and numerous country-specific organizations/companies.

Balance sheet account names and usage depend on the organization's country and the type of organization. Government organizations do not generally follow standards established for individuals or businesses.

If applicable to the business, summary values for the following items should be included in the balance sheet:Assets are all the things the business owns; this will include property, tools, cars, etc.

### Assets

[Current assets](http://en.wikipedia.org/wiki/Current_asset)

1. [Cash and cash equivalents](http://en.wikipedia.org/wiki/Cash_and_cash_equivalents)
2. [Accounts receivable](http://en.wikipedia.org/wiki/Accounts_receivable)
3. [Inventories](http://en.wikipedia.org/wiki/Inventory)
4. [Prepaid expenses](http://en.wikipedia.org/wiki/Prepaid_expenses) for future services that will be used within a year

Non-current assets ([Fixed assets](http://en.wikipedia.org/wiki/Fixed_asset))

1. [Property, plant and equipment](http://en.wikipedia.org/wiki/Property,_plant_and_equipment)
2. Investment property, such as [real estate](http://en.wikipedia.org/wiki/Real_estate) held for investment purposes
3. [Intangible assets](http://en.wikipedia.org/wiki/Intangible_asset)
4. Financial assets (excluding investments accounted for using the equity method, [accounts receivables](http://en.wikipedia.org/wiki/Accounts_receivables), and cash and [cash equivalents](http://en.wikipedia.org/wiki/Cash_equivalents))
5. [Investments](http://en.wikipedia.org/wiki/Investments#Finance) accounted for using the [equity method](http://en.wikipedia.org/wiki/Equity_method)
6. Biological assets, which are living plants or animals. Bearer biological assets are plants or animals which bear agricultural produce for harvest, such as apple trees grown to produce apples and sheep raised to produce wool

### Liabilities

1. [Accounts payable](http://en.wikipedia.org/wiki/Accounts_payable)
2. [Provisions](http://en.wikipedia.org/wiki/Provision_(accounting)) for warranties or court decisions
3. Financial liabilities (excluding provisions and accounts payable), such as [promissory notes](http://en.wikipedia.org/wiki/Promissory_note) and [corporate bonds](http://en.wikipedia.org/wiki/Corporate_bond)
4. Liabilities and assets for current [tax](http://en.wikipedia.org/wiki/Tax)
5. [Deferred tax](http://en.wikipedia.org/wiki/Deferred_tax) liabilities and deferred tax assets
6. Unearned revenue for services paid for by customers but not yet provided

### Equity

The net assets shown by the balance sheet equals the third part of the balance sheet, which is known as the [shareholders' equity](http://en.wikipedia.org/wiki/Shareholders%27_equity). It comprises:

1. Issued capital and [reserves](http://en.wikipedia.org/wiki/Reserve_(accounting)) attributable to equity holders of the [parent company](http://en.wikipedia.org/wiki/Parent_company) (controlling interest)
2. [Non-controlling interest](http://en.wikipedia.org/wiki/Minority_interest) in equity

Formally, shareholders' equity is part of the company's liabilities: they are funds "owing" to shareholders (after payment of all other liabilities); usually, however, "liabilities" is used in the more restrictive sense of liabilities excluding shareholders' equity. The balance of assets and liabilities (including shareholders' equity) is not a coincidence. Records of the values of each account in the balance sheet are maintained using a system of accounting known as [double-entry bookkeeping](http://en.wikipedia.org/wiki/Double-entry_bookkeeping). In this sense, shareholders' equity by construction must equal assets minus liabilities, and are a residual.

Regarding the items in equity section, the following disclosures are required:

1. Numbers of [shares](http://en.wikipedia.org/wiki/Share_(finance)) authorized, issued and fully paid, and issued but not fully paid
2. [Par value](http://en.wikipedia.org/wiki/Par_value) of shares
3. Reconciliation of shares outstanding at the beginning and the end of the period
4. Description of rights, preferences, and restrictions of shares
5. [Treasury shares](http://en.wikipedia.org/wiki/Treasury_share), including shares held by [subsidiaries](http://en.wikipedia.org/wiki/Subsidiary) and associates
6. Shares reserved for issuance under [options](http://en.wikipedia.org/wiki/Option_(finance)) and [contracts](http://en.wikipedia.org/wiki/Contract)
7. A description of the nature and purpose of each reserve within owners' equity

## Sample balance sheet

The following balance sheet is a very brief example prepared in accordance with [IFRS](http://en.wikipedia.org/wiki/IFRS). It does not show all possible kinds of assets, liabilities and equity, but it shows the most usual ones. Because it shows [goodwill](http://en.wikipedia.org/wiki/Goodwill_(accounting)), it could be a [consolidated](http://en.wikipedia.org/wiki/Consolidated_financial_statement) balance sheet. Monetary values are not shown, summary (total) rows are missing as well.

**Balance Sheet of XYZ, Ltd.**

**As of 31 December 2009**

**ASSETS**

[**Current Assets**](http://en.wikipedia.org/wiki/Current_Asset)

[Cash and Cash Equivalents](http://en.wikipedia.org/wiki/Cash_and_Cash_Equivalents)

[Accounts Receivable](http://en.wikipedia.org/wiki/Accounts_Receivable) (Debtors)

*Less: Allowances for Doubtful Accounts*

[Inventories](http://en.wikipedia.org/wiki/Inventory)

[Prepaid Expenses](http://en.wikipedia.org/wiki/Prepaid_Expense)

[Investment Securities](http://en.wikipedia.org/wiki/Consolidation_(business)) (Held for trading)

Other Current Assets

**Non-Current Assets (**[**Fixed Assets**](http://en.wikipedia.org/wiki/Fixed_Asset)**)**

[Property, Plant and Equipment](http://en.wikipedia.org/wiki/Property,_Plant_and_Equipment) (PPE)

*Less:* [*Accumulated Depreciation*](http://en.wikipedia.org/wiki/Accumulated_Depreciation)

Investment Securities ([Available for sale](http://en.wikipedia.org/wiki/Available_for_sale)/Held-to-maturity)

[Investments](http://en.wikipedia.org/wiki/Consolidation_(business)) in [Associates](http://en.wikipedia.org/wiki/Associate_company)

[Intangible Assets](http://en.wikipedia.org/wiki/Intangible_assets) (Patent, Copyright, Trademark, etc.)

*Less: Accumulated Amortization*

[Goodwill](http://en.wikipedia.org/wiki/Goodwill_(accounting))

Other Non-Current Assets, e.g. [Deferred Tax](http://en.wikipedia.org/wiki/Deferred_Tax) Assets, [Lease Receivable](http://en.wikipedia.org/wiki/Finance_lease)

**LIABILITIES and SHAREHOLDERS' EQUITY**

**LIABILITIES**

**Current Liabilities (Creditors: amounts falling due within one year)**

[Accounts Payable](http://en.wikipedia.org/wiki/Accounts_Payable)

Current Income [Tax](http://en.wikipedia.org/wiki/Tax) Payable

Current portion of Loans Payable

[Short-term Provisions](http://en.wikipedia.org/wiki/Provision_(accounting))

Other Current Liabilities, e.g. Unearned Revenue, Deposits

**Non-Current Liabilities (Creditors: amounts falling due after more than one year)**

[Loans](http://en.wikipedia.org/wiki/Loan) Payable

[Issued Debt Securities](http://en.wikipedia.org/wiki/Security_(finance)), e.g. Notes/Bonds Payable

[Deferred Tax](http://en.wikipedia.org/wiki/Deferred_Tax) Liabilities

[Provisions](http://en.wikipedia.org/wiki/Provision_(accounting)), e.g. Pension Obligations

Other Non-Current Liabilities, e.g. [Lease Obligations](http://en.wikipedia.org/wiki/Finance_lease)

**SHAREHOLDERS' EQUITY**

[**Paid-in Capital**](http://en.wikipedia.org/wiki/Paid-in_Capital)

[Share Capital](http://en.wikipedia.org/wiki/Share_Capital) ([Ordinary Shares](http://en.wikipedia.org/wiki/Ordinary_Shares), [Preference Shares](http://en.wikipedia.org/wiki/Preference_Shares))

[Share Premium](http://en.wikipedia.org/wiki/Share_Premium)

*Less:* [*Treasury Shares*](http://en.wikipedia.org/wiki/Treasury_Share)

[**Retained Earnings**](http://en.wikipedia.org/wiki/Retained_Earnings)

[**Revaluation**](http://en.wikipedia.org/wiki/Revaluation_of_fixed_assets#U.S._GAAP_on_Upward_Revaluation_of_Fixed_Assets)[**Reserve**](http://en.wikipedia.org/wiki/Reserve_(accounting))

[**Accumulated Other Comprehensive Income**](http://en.wikipedia.org/wiki/Accumulated_Other_Comprehensive_Income)

## Accounting equation

The '*basic****accounting equation'*** is the foundation for the [double-entry bookkeeping system](http://en.wikipedia.org/wiki/Double-entry_bookkeeping_system). For each transaction, the total debits equal the total credits.

 Assets = Liabilities + Capital 

 A = L + C 

In a corporation, capital represents the stockholders' equity.

In practice

For example: A student buys a [computer](http://en.wikipedia.org/wiki/Computer) for $945. This student borrowed $500 from his best friend and spent another $445 earned from his part-time job. Now his [assets](http://en.wikipedia.org/wiki/Asset) are worth $945, [liabilities](http://en.wikipedia.org/wiki/Liability_(accounting)) are $500, and equity $445.

The formula can be rewritten:

**Assets** - **Liabilities** = (Shareholders' or Owners' **Equity** or Capital)

Now it shows owners' [interest](http://en.wikipedia.org/wiki/Interest) is equal to [property](http://en.wikipedia.org/wiki/Property) (assets) minus [debts](http://en.wikipedia.org/wiki/Debts) (liabilities). Since in a corporation owners are [shareholders](http://en.wikipedia.org/wiki/Shareholders), owner's interest is called [shareholders' equity](http://en.wikipedia.org/wiki/Shareholders%27_equity). Every [accounting](http://en.wikipedia.org/wiki/Accounting) [transaction](http://en.wikipedia.org/wiki/Financial_transaction) affects at least one element of the equation, but always balances.

These are some simple examples, but even the most complicated transactions can be recorded in a similar way. This equation is behind [debits](http://en.wikipedia.org/wiki/Debit), [credits](http://en.wikipedia.org/wiki/Credit_(accounting)), and journal entries.

This equation is part of the transaction analysis model, for which we also write

Owners equity = Contributed Capital + Retained Earnings

Retained Earnings = Net Income – Dividends and

Net Income = Income − Expenses

The equation resulting from making these substitutions in the accounting equation may be referred to as the *expanded* accounting equation, because it yields the breakdown of the [equity](http://en.wikipedia.org/wiki/Ownership_equity) component of the equation

Expanded Accounting Equation

Assets = Liabilities + Stockholders' Equity

Assets = Liabilities + Common Stock + Retained Earnings

Assets = Liabilities + Common Stock + Net Income - Dividends

Assets = Liabilities + Common Stock + Income - Expenses - Dividends

Balance sheet

An elaborate form of this equation is presented in a [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet) which lists all assets, liabilities, and equity, as well as totals to ensure that it balances.

## Accounts payable

**Accounts payable**, also known as Creditors, is money owed by a business to its suppliers and shown on its Balance Sheet as a liability. An accounts payable is recorded in the Account Payable sub-ledger at the time an invoice is vouchered for payment. Vouchered, or vouched, means that an invoice is approved for payment and has been recorded in the General Ledger or AP subledger as an outstanding, or open, liability because it has not been paid. Payables are often categorized as Trade Payables, payables for the purchase of physical goods that are recorded in Inventory, and Expense Payables, payables for the purchase of goods or services that are expensed. Common examples of Expense Payables are advertising, travel, entertainment, office supplies and utilities. *A/P* is a form of [credit](http://en.wikipedia.org/wiki/Credit_(finance)) that suppliers offer to their customers by allowing them to pay for a [product](http://en.wikipedia.org/wiki/Good_(economics)) or [service](http://en.wikipedia.org/wiki/Service_(economics)) after it has already been received. Suppliers offer various payment terms for an invoice. Payment terms may include the offer of a cash discount for paying an invoice within a defined number of days. For example, 2%, 30 Net 31 terms mean that the payor will deduct 2% from the invoice if payment is made within 30 days. If the payment is made on Day 31 then the full amount is paid.

In [households](http://en.wikipedia.org/wiki/Household), accounts payable are ordinarily bills from the [electric company](http://en.wikipedia.org/wiki/Electrical_power_industry), [telephone](http://en.wikipedia.org/wiki/Telephone) company, [cable television](http://en.wikipedia.org/wiki/Cable_television) or [satellite dish](http://en.wikipedia.org/wiki/Satellite_dish) service, [newspaper](http://en.wikipedia.org/wiki/Newspaper) [subscription](http://en.wikipedia.org/wiki/Subscription), and other such regular services. Householders usually track and pay on a monthly basis by hand using cheques, credit cards or internet banking. In a business, there is usually a much broader range of services in the A/P file, and [accountants](http://en.wikipedia.org/wiki/Accountants) or [bookkeepers](http://en.wikipedia.org/wiki/Bookkeeper) usually use [accounting software](http://en.wikipedia.org/wiki/Accounting_software) to track the flow of money into this [liability](http://en.wikipedia.org/wiki/Liability_(accounting)) account when they receive invoices and out of it when they make payments. Increasingly, large firms are using specialized Accounts Payable automation solutions (commonly called ePayables) to automate the paper and manual elements of processing an organization's invoices.

Commonly, a supplier will ship a product, issue an invoice, and collect payment later, which describes a [cash conversion cycle](http://en.wikipedia.org/wiki/Cash_conversion_cycle), a period of time during which the supplier has already paid for raw materials but hasn't been paid in return by the final customer.

When the invoice is received by the purchaser it is matched to the [packing slip](http://en.wikipedia.org/wiki/Packing_slip) and [purchase order](http://en.wikipedia.org/wiki/Purchase_order), and if all is in order, the invoice is paid. This is referred to as the three-way match.The three-way match can slow down the payment process, so the method may be modified. For example, three-way matching may be limited solely to large-value invoices, or the matching is automatically approved if the received quantity is within a certain percentage of the amount authorized in the purchase order.

Expense administration

Expense administration is usually closely related to accounts payable, and sometimes those functions are performed by the same employee. The expense administrator verifies employees' [expense reports](http://en.wikipedia.org/wiki/Expense_report), confirming that receipts exist to support airline, ground transport, meals and entertainment, telephone, hotel, and other expenses. This documentation is necessary for tax purposes and to prevent reimbursement of inappropriate or erroneous expenses. Airline expenses are, perhaps, the most prone to fraud because of the high cost of air travel and the confusing nature of airline-related documentation, which can consist of an array of reservations, receipts, and actual tickets.

Internal controls

A variety of checks against abuse are usually present to prevent [embezzlement](http://en.wikipedia.org/wiki/Embezzlement) by accounts payable personnel. [Segregation of duties](http://en.wikipedia.org/wiki/Segregation_of_duties) is a common control. Nearly all companies have a junior employee process and print a cheque and a senior employee review and sign the cheque. Often, the accounting software will limit each employee to performing only the functions assigned to them, so that there is no way any one employee – even the [controller](http://en.wikipedia.org/wiki/Comptroller) – can singlehandedly make a payment.

Some companies also separate the functions of adding new vendors and entering vouchers. This makes it impossible for an employee to add himself as a vendor and then cut a cheque to himself without colluding with another employee. This file is referred to as the master vendor file. It is the repository of all significant information about the company's suppliers. It is the reference point for accounts payable when it comes to paying invoices.[[3]](http://en.wikipedia.org/wiki/Accounts_payable#cite_note-2)

In addition, most companies require a second signature on cheques whose amount exceeds a specified threshold.

Accounts payable personnel must watch for fraudulent invoices. In the absence of a [purchase order](http://en.wikipedia.org/wiki/Purchase_order) system, the first line of defense is the approving manager. However, A/P staff should become familiar with a few common problems, such as "[Yellow Pages](http://en.wikipedia.org/wiki/Yellow_Pages)" [rip-offs](http://en.wikipedia.org/wiki/Ripoff) in which fraudulent operators offer to place an advertisement. The walking-fingers logo has never been trademarked, and there are many different Yellow Pages-style directories, most of which have a small distribution. According to an article in the Winter 2000 [American Payroll Association](http://en.wikipedia.org/wiki/American_Payroll_Association)'s *Employer Practices*, "Vendors may send documents that look like invoices but in small print they state "this is not a bill." These may be charges for directory listings or advertisements. Recently, some companies have begun sending what appears to be a rebate or refund check; in reality, it is a registration for services that is activated when the document is returned with a signature."

In accounts payable, a simple mistake can cause a large overpayment. A common example involves duplicate invoices. An invoice may be temporarily misplaced or still in the approval status when the vendors calls to inquire into its payment status. After the A/P staff member looks it up and finds it has not been paid, the vendor sends a duplicate invoice; meanwhile the original invoice shows up and gets paid. Then the duplicate invoice arrives and inadvertently gets paid as well, perhaps under a slightly different invoice number.

Audits of accounts payable

Auditors often focus on the existence of approved invoices, expense reports, and other supporting documentation to support cheques that were cut. The presence of a confirmation or statement from the supplier is reasonable proof of the existence of the account. It is not uncommon for some of this documentation to be lost or misfiled by the time the audit rolls around. An auditor may decide to expand the sample size in such situations.

Auditors typically prepare an ageing structure of accounts payable for a better understanding of outstanding debts over certain periods (30, 60, 90 days, etc.). Such structures are helpful in the correct presentation of the balance sheet as of year end

Accounts Payable Automation

**ePayables** are defined as the technology or process automation solutions that automate any part of the accounts payable ("AP") process. The key to Accounts Payable Automation is to develop or invest in technology that will enable the company to free up labor from task the technology can perform. Examples are opening mail, scanning, entry in to the Accounting System or ERP System and filing(4).

There are three main components in AP Automation.

1. 100% Electronic Invoices
2. Event Driven Workflow
3. Reporting Layer to Track all Actions

By automating the process, companies can greatly reduce the time it takes to process an invoice. In most cases it can be taken down from several weeks or months to a matter of days. Once an invoice is available electronically, it can automatically be matched against the order and routed for payment and sent to the AP department for processing. Technology also automates the processing of periodic or contract-based purchase invoices. When technology like this is fully implemented, most invoices no longer require human intervention. [[5]](http://en.wikipedia.org/wiki/Accounts_payable#cite_note-4)

Accounts receivable

**Accounts receivable** also known as Debtors, is money owed to a business by its clients (customers) and shown on its Balance Sheet as an asset.[[1]](http://en.wikipedia.org/wiki/Accounts_receivable#cite_note-0) It is one of a series of [accounting](http://en.wikipedia.org/wiki/Accounting) transactions dealing with the billing of a [customer](http://en.wikipedia.org/wiki/Customer) for [goods](http://en.wikipedia.org/wiki/Good_(economics)) and [services](http://en.wikipedia.org/wiki/Service_(economics)) that the customer has ordered.

## Overview

Accounts receivable represents money owed by entities to the firm on the sale of products or services on credit. In most business entities, accounts receivable is typically executed by generating an [invoice](http://en.wikipedia.org/wiki/Invoice) and either mailing or [electronically](http://en.wikipedia.org/wiki/Electronic_billing) delivering it to the customer, who, in turn, must pay it within an established timeframe, called *credit terms* or *payment terms*.  
  
The accounts receivable departments use the *sales ledger*, this is because a sales ledger normally records [[2]](http://en.wikipedia.org/wiki/Accounts_receivable#cite_note-1):  
- The sales a business has made.  
- The amount of money received for goods or services.  
- The amount of money owed at the end of each month varies (debtors).  
  
The accounts receivable team is in charge of receiving funds on behalf of a company and applying it towards their current pending balances.  
Collections and cashiering teams are part of the accounts receivable department. While the collection's department seeks the debtor, the cashiering team applies the monies received.

## Payment terms

An example of a common payment term is [Net 30](http://en.wikipedia.org/wiki/Net_30), which means that payment is due at the end of 30 days from the date of invoice. The [debtor](http://en.wikipedia.org/wiki/Debtor) is free to pay before the due date; businesses can offer a discount for early payment. Other common payment terms include *Net 45*, *Net 60* and 30 days end of month.

Booking a receivable is accomplished by a simple accounting transaction; however, the process of maintaining and collecting payments on the accounts receivable subsidiary account balances can be a full-time proposition. Depending on the industry in practice, accounts receivable payments can be received up to 10 – 15 days after the due date has been reached. These types of payment practices are sometimes developed by industry standards, corporate policy, or because of the financial condition of the client.

Since not all customer debts will be collected, businesses typically estimate the amount of and then record an [allowance for doubtful accounts](http://en.wikipedia.org/wiki/Allowance_for_bad_debts)[[3]](http://en.wikipedia.org/wiki/Accounts_receivable#cite_note-2) which appears on the balance sheet as a [contra account](http://en.wikipedia.org/wiki/Contra_account) that offsets total accounts receivable. When accounts receivable are not paid, some companies turn them over to third party [collection agencies](http://en.wikipedia.org/wiki/Collection_agency) or [collection attorneys](http://en.wikipedia.org/wiki/Creditor%27s_rights) who will attempt to recover the debt via negotiating payment plans, settlement offers or pursuing other legal action.

Outstanding advances are part of accounts receivable if a company gets an order from its customers with payment terms agreed upon in advance. Since billing is done to claim the advances several times, this area of collectible is not reflected in accounts receivables. Ideally, since advance payment occurs within a mutually agreed-upon term, it is the responsibility of the accounts department to periodically take out the statement showing advance collectible and should be provided to sales & marketing for collection of advances. The payment of accounts receivable can be protected either by a [letter of credit](http://en.wikipedia.org/wiki/Letter_of_credit) or by [Trade Credit Insurance](http://en.wikipedia.org/wiki/Trade_Credit_Insurance)

## Accounts Receivable Age Analysis

The Accounts Receivable Age Analysis Printout, also known as the Debtors Book is divided in categories for current, 30 days, 60 days, 90 days, 120 days, 150 days and 180 days and overdue that are produced in Modern Accounting Systems. The printout is done in the order of the Chart of Accounts for the Accounts Receivable and/or Debtors Book. The option to include Zero Balances outstanding or to specifically leave it out is also possible in the printout features.

## Special uses

Companies can use their accounts receivable as [collateral](http://en.wikipedia.org/wiki/Collateral_(finance)) when obtaining a [loan](http://en.wikipedia.org/wiki/Loan) ([asset-based lending](http://en.wikipedia.org/wiki/Asset-based_lending)). They may also sell them through [factoring](http://en.wikipedia.org/wiki/Factoring_(finance)) or on an [exchange](http://en.wikipedia.org/wiki/Exchange). Pools or portfolios of accounts receivable can be sold in [capital markets](http://en.wikipedia.org/wiki/Capital_markets) through [securitization](http://en.wikipedia.org/wiki/Securitization).

For tax reporting purposes, a general provision for bad debts is not an allowable deduction from profit[[4]](http://en.wikipedia.org/wiki/Accounts_receivable#cite_note-3) - a business can only get relief for specific debtors that have gone bad. However, for financial reporting purposes, companies may choose to have a general provision against bad debts consistent with their past experience of customer payments, in order to avoid over-stating debtors in the [balance sheet](http://en.wikipedia.org/wiki/Balance_sheet).