

Enterprise

Enterprise: is the factor of production that generates ideas and combines the other three factors of production in order to produce goods and services. It undertakes all the inherent risks of failure in the hope of making a profit

The reward to Enterprise as a factor of production is profit.

Entrepreneur: is a person who takes a risk to make a profit by bringing together the other three factors of production to provide goods and services

Economic Characteristics of Enterprise

Like all factors of production, enterprise has certain characteristics that make it unique from the other factors. These are

- 1) **It can Earn a Loss:** It is the only factor that can earn a negative return (loss). This does not arise with the other factors of production as they are guaranteed a return.
- 2) **Returns can Vary:** The returns can vary from super normal profits to losses.
- 3) **Return is Residual:** Enterprise receives its return only after the other factors have received theirs • It is different from the other factors since their payments are agreed in advance (by a contract).
- 4) **Organises Economic Activity:** Enterprise is the factor of production that organizes the other three factors to produce goods and services. Without enterprise these other factors would lye idle and nothing would be produced.

Do all Entrepreneurs Earn the Same Level of Profit?

No, all Entrepreneurs do not earn the same level of profit.

This is due to a rent of ability. Some are better than others and can earn a supernormal profit or an economic rent. The entrepreneur cannot be replaced easily by another because of talent and business acumen possessed. If the entrepreneur works in a more competitive industry he may earn lower profits than an entrepreneur in a less competitive industry.

The Economic Reward to Enterprise

- 1) **Normal Profits (AR = AC)**: is the minimum payment necessary to keep the entrepreneur in the business in the long run. Normal Profits are the Supply Price of the entrepreneur and are earned when the business is operating at the point where $MC = MR$ and MC is rising faster after that point. Normal Profits can also be viewed as a Fixed Cost to the business as the entrepreneur will require at least this much to keep him in the business.
- 2) **Supernormal Profits (AR > AC)**: is the name given to all revenue that is earned in excess of Normal Profits. It can be reinvested back into the firm or it can be taken by the entrepreneur as higher earnings. It is earned when the business is operating at the point where $AR > AC$. It is almost impossible for the entrepreneur to earn SNP in the longrun (except for a monopolist) and as such SNP is usually seen as an economic rent.
- 3) **Loss (AR < AC)**: If the entrepreneur cannot organise the production process in such a way that the revenue from sales exceeds the cost of production, then he makes a loss. This can only be incurred in the short run and if not rectified, the business will close down.

Insurable and Non Insurable Risks

It is clearly stated in the definition of the entrepreneur that entrepreneur's face risks. This is due to the fact that if an entrepreneur's idea is not successful, the entrepreneur could incur a loss.

But there are other risks faced by the entrepreneur, like theft or damage to their property. Some risks the entrepreneur can insure against, other risks they cannot.

Insurable Risks: Those risks which can be mathematically estimated and an entrepreneur can insure against occurring and an insurance policy can be purchased to provide compensation in the event of loss

E.g. an insurance policy can be taken out against fire damage to a property.

Insurable Risks	
Against	Name of Policy
Damage to factory buildings	Buildings and Contents insurance
Accidents to workers or members of the public	Employers Liability insurance Public Liability insurance
Dishonesty by employees	Fidelity Guarantee insurance
Customers injured from products	Product Liability insurance
Money stolen	Cash insurance

Non - Insurable Risks: Those risks which an entrepreneur cannot insure against occurring and an insurance policy cannot be purchased to provide compensation.

Non - Insurable Risks

- 1) Loss of profit.
- 2) Bad decision-making.
- 3) Industrial relations disputes/Strikes
- 4) Changes in taste or fashion.
- 5) Entry of competition into the industry.
- 6) Changes in competitive conditions e.g. new legislation.

Risk Reduction Strategies

In order to reduce the risks that they face, intelligent entrepreneurs take pre-emptive strategies in order to combat these risks before they arise. These include

Market Research	Asses Durability of demand
Hire experienced Staff	Research Competitors
Ensure Healthy Industrial Relations (HRM)	Gain a Patent

Who is the Entrepreneur?

In a free market economy such as ours, the factor of production, enterprise, is supplied by private individuals. E.g. the ladies selling fruit on Moore Street are entrepreneurs as they bare the risks involved in production. If nobody buys their fruit they are left with a loss. These ladies can also be called sole traders.

Partnerships like McKennaDurcan solicitors operate in the same way. They have a business idea (supply legal services in order to make a profit) and again bare the risks involved of being entrepreneurs, namely suffering a loss if their service is not good enough or a downturn in the economy.

When referring to semi-state bodies like the E.S.B., the tax payer is considered to be the entrepreneur as any losses suffered by this semi-state body must be paid for by the tax payer in the form of their taxes.

Sometimes, when businesses are closing, the workers use their redundancy packages to buy the business from their former employers. This occurred when the coal miners in Wales used their redundancy money to buy the mine and they ran it (successfully) themselves. This is known as a workers co-operative. In cases like this the workers themselves are the entrepreneurs as they are the ones baring the risk of business failure.

It is important to realize that managers who do not own shares in the company that they are managing are not entrepreneurs. A manager is a person who is paid a salary for their work and as such is a supplier of labour and not an entrepreneur as he bears no risk due to the fact that his salary will be paid if the company makes a profit or not (this is at least true in the short run).

A Centrally Planned Economy

A centrally planned economy is an economy where the state is the sole owner of the factors of production. No private firms are allowed and as such the state is the sole provider of the factor of production enterprise.

The state decides what goods are to be produced, what quantity of these goods are to be produced, what combination of factors are to be used in the production of these goods and what price is to be charged.

While it might seem a good idea to plan everything from the center at first appearance, it has failed in every country that it has been tried and also seems to be associated with dictatorship governments. Stalin and the USSR, Castro and Cuba, Pol Pot and Cambodia. People cite China as

an economically successful communist country, however China implemented capitalist reforms in the 1970's and since then has been operating as a free market economy.

The problem with socialism, communism (centrally planned economies in general) is the lack of the profit motive. Since there were no private entrepreneurs, there was no incentive for people to work harder to make profits. There was no incentive for companies to introduce new methods of production to gain an advantage over their rivals as there was no competition. If a business made a loss, it would receive remuneration from the government resulting in a complete lack of incentive for any type of innovation. This lack of innovation ensured that the standard of living didn't rise for the unfortunate people living in these economies.

While this system did eliminate a lot of waste (e.g. the money spent on advertising, removing the unnecessary duplication of resources etc), it created immeasurable more waste by requiring huge state bureaucracies to make production decisions, administer prices etc. But most importantly, it failed where the market cannot. It did not provide people with the products that they actually wanted. This was because consumers had no part in the decision making processes regarding what was to be produced. People were left with too much of what they either didn't want or didn't need and not enough of what they wanted.

The cost of business failure in a centrally planned economy is borne by the people living there. Their taxes are the resources used to prop up the inefficient businesses that inevitably arise in such an economic system. Therefore, everybody has to pay for the inefficient business that are subsidized by the state rather than forced to shut down. In a free market economy, the cost of incorrect planning or inefficient business practices is borne solely by the entrepreneur. That is the person that made the mistake pays for the mistake.

Any advantages that may be enjoyed by operating a centrally planned economy are more than outweighed by the disadvantages incurred from operating one. Anecdotal evidence stems from the efforts made by Eastern European countries to introduce a free market economic system after the fall of the Soviet Union.

Free Enterprise (Laissez Faire): is an Economic System where the allocation of society's resources, the decisions on what goods are to be produced, how they are produced and who gets them are decided by the interactions of individuals and entrepreneurs.

NOTE: Free Market Capitalism is another name for a Free Enterprise economic system.

ADVANTAGES OF FREE ENTERPRISE

- 1) **Choice:** Consumers with income have a wide choice of goods and services.
- 2) **Efficiency:** Incentives exist for producers to be efficient. Companies who are inefficient will be forced out by companies who have lower costs.
- 3) **Innovation:** Producers who are innovative will be rewarded through increased sales on the market.
- 4) **Economic Growth:** As all individuals are motivated by self-interest, each will strive towards their maximum efficiency and so aid economic growth.
- 5) **Less Bureaucracy:** As decisions are made by individuals within the society, the costs of a large administration to administer matters is significantly reduced.

The Importance of Entrepreneurs to the Economy

Entrepreneurs are exceptionally important to the development of any economy.

- 1) **Organises Economic Activity:** Entrepreneurs organise the other three factors to produce goods and services. Without enterprise these other factors would lie idle and nothing would be produced.
- 2) **Provide Goods and Services:** Entrepreneurs are the ones that provide the goods and services that residents of an economy enjoy. Without these goods and services that entrepreneurs provide residents of an economy would not be able to provide anything and as such entrepreneurs provide a greater choice and standard of living for the rest of us.
- 3) **Entrepreneurs provide Employment:** Entrepreneurs organise the other three factors of production into productive units which create employment by hiring staff.
- 4) **Increase Government Tax Revenue:** They can do this in a number of ways.

- i) Tax revenue earned from taxing the business (Corporate taxes)
 - ii) Tax earned from taxing the entrepreneur's personal income (PAYE)
 - iii) PAYE and PRSI on the earnings of the employees
 - iv) Indirect taxes on the goods and services provided by the entrepreneurs (VAT)
- 5) **Increase National Income:** One way of measuring National Income is by adding up the total value of all the goods and services produced in the economy in one year. Since entrepreneurs are responsible for all of this production, it is the entrepreneur that is responsible for generating all wealth in society.
- 6) **Help Balance of Trade:** All the goods that Ireland exports are made by entrepreneurs. The more goods that Ireland exports the more favourable our balance of trade. Entrepreneurs are responsible for the production of the goods that are exported. Therefore they help our balance of trade.

The Role of Profits in a Free Market Economy

- 1) **Encourage Risk Taking:** Profits are a prerequisite for encouraging entrepreneurs to undertake the risks inherent in business. Without profits no firms would supply goods or services.
- 2) **Indicate the Best Use of Resources:** Profits are an indication to entrepreneurs what goods and services consumers want (demand) and hence indicate what areas are the most suitable for the use of scarce resources.
- 3) **Encourage Investment:** When profits are earned this may encourage entrepreneurs to invest further in ventures.
- 4) **Provide Funds for Expansion:** Entrepreneurs may use the profits earned to invest in their existing business to expand their existing activities / diversify production etc.
- 5) **Continuity of Production:** If normal profits are not earned then an entrepreneur will cease operating, hence they are essential to ensure that production continues.
- 6) **SNP Reward Innovation:** Those entrepreneurs who earn SNP's do so because they may be more efficient and or because they are innovative or because they are minimizing their costs of production.
- 7) **Source of Revenue for the Government:** Any profits earned by entrepreneurs are taxed (with exceptions) by the government and become a source of revenue for the state. They can use these profits to further develop the economy.

- 8) **SNP's may Promote Mergers / Takeovers:** The existence of SNP's within some industries may entice large multinationals to takeover these profitable business so that they increase their overall profits / gain a foothold in the Irish market.

NOTE: a Quasi Rent is a short term or temporary economic rent which is earned by a factor of production, e.g. if there are a shortage of tradesmen (which there were during the boom years) then people currently working as tradesmen can earn an economic rent until more tradesmen enter the industry and drive the earnings down.

A gifted entrepreneur can earn in excess of normal profit due to his innate business acumen and this excess will not be eroded by competition. Such earnings are often referred to as rent of ability and can exist indefinitely.

Reasons for the survival of small firms in the Irish economy, even though they do not have the benefits of economies of scale.

- 1) **Small Size of Market:** The restricted size of the market may not facilitate the operation of large scale business e.g. in a rural area, a small shop may be viable while a large supermarket may not.
- 2) **Personal Services:** Consumers may desire personal attention in the provision of goods or services and a small firm may be the only type of business which can provide this e.g. a plumber providing repair services to households.
- 3) **Consumer Loyalty:** A small firm may have built up a reputation over the years in the provision of goods and services to its customers and consumers may respond by being loyal to that firm, making it difficult for other firms to gain entry.
- 4) **Viable Community:** Citizens in smaller communities may support local business so that the continuity of supply is ensured. e.g. in many areas throughout Ireland communities wish to maintain the existence of 'community' hospitals. Enterprise Boards encourage individuals to establish small businesses.
- 5) **Traditional / Niche Markets:** The type of product / service being supplied might make it more suitable for a small firm.

Examples include: wedding planners; handmade/ craft products; perishable products etc.

A small firm may find that it easier to locate close to the market where it might be difficult for a larger firm to do so e.g. roadside sellers of local produce can be flexible in choosing their location.

- 6) **Nature of the Commodity:** Heavy goods which are costly to transport may be manufactured locally on a small scale to supply local markets e.g. the manufacture of concrete blocks in areas which service local markets.
- 7) **Membership of voluntary groups/Alliances between firms at different stages of production:** Some firms producing on a small scale may offset the disadvantage they have in competition with large producers by adopting a joint marketing strategy with other small suppliers e.g. hotel groups, individually owned grocery shops trading under a shared name

What Action could the Irish Government take to Promote Enterprise during a Recession

- 1) **Enterprise Education:** If the government encouraged greater emphasis on enterprise education in schools and colleges then more individuals may be willing to undertake the risks involved.
- 2) **Taxation Policies:** If the government maintains corporation profits tax rates then individuals may see the possibility of greater profitability. Similarly a reduction in VAT rates may increase demand for commodities and increase sales.
- 3) **Government Policies:** If the government reduced the regulations involved in setting up a business or removed administration obstacles then more people might become entrepreneurs. Also, if they offer grants and other incentives for establishing a business then more people might do so / create a favourable business environment.
- 4) **Labour Market Policies:** The availability of an educated / skilled workforce acts an incentive to individuals to establish a business. Investment in universities / 3rd level colleges.
- 5) **Confidence in Economy:** If the government, through its economic and social policies, presents a positive outlook about the economy then individuals may take more risk.
- 6) **Develop Infrastructure:** Investment in communications technology through the provision of broadband access will encourage people to start up business.

- 7) **Improve Competitiveness:** Currently the competitiveness of Irish industry is improving. If measures can be taken to improve competitiveness further then individuals may be encouraged to start a business e.g. more competitive quotes for communications, insurance, energy etc.
- 8) **Availability of Bank Credit:** By stabilising the banks the government may make it possible for the banks to provide credit and so encourage people to borrow and establish a business.
- 9) **Government Initiatives:** Examples include: 'Action Plan for Jobs 2012' provides support for businesses struggling to access credit with €100m Micro Finance Loan Scheme, €150m Development Capital Scheme and a Loan Guarantee Scheme.