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Introduction to Business

TABLE OF CONTENTS

About *Introduction to Business*

Introduction to Business is designed to meet the scope and sequence requirements of foundational business courses. The textbook presents business principles and emerging trends in fields including management, leadership, production, marketing, and finance. Through this content, students will acquire the knowledge, skills, and competencies to prepare for the competitive workplace.

Coverage and scope

Introduction to Business covers the scope and sequence of most introductory business courses. The book provides detailed explanations in the context of core themes such as ethics, entrepreneurship, customer satisfaction, global business, and managing change. Introduction to Business includes hundreds of current business examples from a range of industries, geographic locations, and featuring a variety of individuals. The outcome is a balanced approach to the theory and application of business concepts, with attention to the knowledge and skills necessary for student success in this course and beyond.

Pedagogical foundation

Consistent, integrated learning. Targeted learning outcomes are listed at the beginning of each chapter and then repeated throughout the chapter. The learning outcomes connect to the text and the additional resources that accompany *Introduction to Business*. After reading each section, students can test their retention by answering the questions in the Concept Checks. Every learning goal is further reinforced by a summary.

Hundreds of business examples to bring concepts to life. This book is designed to speak to the typical student. We have done a lot of research about student needs, abilities, experiences, and interests, and then we have shaped the text around them. We have used experiences both inside and outside the classroom to enrich a book that is both readable and enjoyable. We believe that the real business applications found throughout every chapter set the standard for readability and understanding of key concepts.

Learning business terminology, made easy. As students begin to study business, they will explore new words and concepts. To help them learn this language of business, we define each new term in the chapter, display the terms in bold, and offer a complete glossary at the end of the book.

Engaging business themes

Ethics. Business presents outstanding opportunities to do good. Through responsible business practices and the development and distribution of helpful products and services, businesspeople can positively affect their community. A paramount theme of this text is that business must be conducted in an ethical and socially responsible manner. **Chapter 2**, Making Ethical Decisions and Managing a Socially Responsible Business, is completely devoted to business ethics and social responsibility. We discuss techniques for setting personal ethical standards, how managers influence organizational ethics, tools for creating employee ethical awareness, and the concept of individual and corporate responsibility. *Introduction to Business* also features ethics activities at the end of each chapter. All ethical dilemmas are taken right out of today’s business world.

Customer satisfaction and quality. Because customer satisfaction and quality are the foundation of all business principles, these important topics are addressed in most chapters within *Introduction to Business*. Each chapter stresses that satisfied customers who experience high-quality products and services become loyal customers. A box in every chapter called “Customer Satisfaction and Quality” demonstrates how these concepts are applied in actual companies.

Managing change. Change in the business or consumer environment can lead to failures like Kodak’s and successes like Apple's. The Managing Change boxed feature describes how companies have recognized and responded to changes in technology, competition, economic forces, demographics, and culture.

Entrepreneurship and small business management. Because many students will either open their own businesses or go to work for small organizations, entrepreneurship and small business principles are covered throughout the text. **Chapter 5**, Entrepreneurship: Starting and Managing Your Own Business, delivers interesting discussions on starting and managing a small business and the associated advantages and disadvantages. In addition, a feature called "Catching the Entrepreneurial Spirit" offers practical insights into the challenges and rewards of actually owning and managing a small business.

Global business economy. In **Chapter 3**, Competing in the Global Marketplace, we discuss why global trade is important to the United States, why nations trade, barriers to international trade, how companies enter the global marketplace, and a host of other international concepts and topics. The Trends section of each chapter frequently includes a discussion of how globalization will affect specific business activities. In addition, our Global Business box demonstrates how businesses are expanding their workforce, products, and customer base throughout the world in order to grow.

Features

Rather than provide a dry recitation of facts, we illustrate concepts with contemporary examples. In addition to the in-text examples, we have several boxed features that provide more extensive examples in areas of importance in today's business environment. Each of the boxed features described below includes a series of critical thinking questions to prompt the student to consider the implications of each business strategy.

Ethics in Practice. Ethics in Practice features demonstrate how businesses are responsible not only to the bottom line, but to providing goods and services in a responsible manner.

Customer Satisfaction and Quality. Because customer satisfaction and quality are essential to attracting and keeping customers, the Customer Satisfaction and Quality box addresses how these concepts are illustrated and applied in actual companies.

Expanding Around the Globe. Upon entering today's workplace, you are very likely to conduct business with colleagues, clients, and vendors from around the world. The Expanding Around the Globe feature offers insights into the global economy and highlights the strategies firms take to expand their business and improve their productivity by utilizing global resources.

Managing Change. The turbulent business climate requires companies to adapt their business strategies in response to a variety of economic, social, competitive, and technological forces. The Managing Change feature highlights how businesses have altered their business strategies in response to these forces.

Catching the Entrepreneurial Spirit. This feature highlights the challenges and opportunities available in small businesses and other entrepreneurial ventures.

Activities and cases that put knowledge to work

Introduction to Business helps students develop a solid grounding in the skills that they can apply in the workplace. These skill-building activities and resources help build and polish competencies that future employers will value.

Preparing for tomorrow's workplace skills and team activities. These activities are designed to help build students' business skills and to help them practice teamwork. We have developed assignments focused on five important workplace competencies: using and allocating resources, working with others, acquiring and using information, understanding systems, and working with technology. Team activities in every chapter give students an opportunity to work together, building communication skills and interpersonal skills.

Ethics activities. Ethics activities at the end of each chapter present real-world ethical challenges and prompt students to choose the most ethical course of action.

Working the net activities. These activities guide students through a step-by-step analysis of actual e-business practices and give them opportunities to build online research skills.

Creative thinking cases. The Creative Thinking case in each chapter invites students to explore business strategies of various companies, analyze business decisions, and prepare comments.

Additional resources

Community Hubs

OpenStax partners with the Institute for the Study of Knowledge Management in Education (ISKME) to offer Community Hubs on OER Commons – a platform for instructors to share community-created resources that support OpenStax books, free of charge. Through our Community Hubs, instructors can upload their own materials or download resources to use in their own courses, including additional ancillaries, teaching material, multimedia, and relevant course content. We encourage instructors to join the hubs for the subjects most relevant to your teaching and research as an opportunity both to enrich your courses and to engage with other faculty.

To reach the Community Hubs, visit www.oercommons.org/hubs/OpenStax.

Student and instructor resources

We’ve compiled additional resources for both students and instructors, including Getting Started Guides, an instructor’s manual, test bank, and image slides. Instructor resources require a verified instructor account, which you can apply for when you log in or create your account on OpenStax.org. Take advantage of these resources to supplement your OpenStax book.

Comprehensive instructor’s manual. Each component of the instructor’s manual is designed to provide maximum guidance for delivering the content in an interesting and dynamic manner. The instructor’s manual includes an in-depth lecture outline, which is interspersed with lecture “tidbits” that allow instructors to add timely and interesting enhancements to their lectures. Authored by Linda Hefferin, Elgin Community College.

Test bank. With nearly 2,000 true/false, multiple-choice, fill-in-the-blank, and short answer questions in our test bank, instructors can customize tests to support a variety of course objectives. The test bank is available in Word format. Authored by Amit Shah, Frostburg State University.

PowerPoint lecture slides. The PowerPoint slides provide images and descriptions as a starting place for instructors to build their lectures.

Technology partners

As allies in making high-quality learning materials accessible, our technology partners offer optional low-cost tools that are integrated with OpenStax books. To access the technology options for your text, visit your book page on OpenStax.org.

About the authors

Senior contributing authors

Lawrence J. Gitman, San Diego State University - Emeritus
Lawrence J. Gitman is a prolific author, with over fifty published articles and a number of best-selling college textbooks (some with coauthors). In addition to this book, his works include *Personal Financial Planning, Fourteenth Edition* (2017), *PFIN 6 (2018)*, *Fundamentals of Investing, Thirteenth Edition,* (2017), Principles *of Managerial Finance, Fourteenth Edition* (2015), and *Principles of Managerial Finance, Brief, Seventh Edition* (2015). His books have been used by more than two million college students. Dr. Gitman is a CFP® and has served as a member of the Certified Financial Planner Board of Standards and as an associate editor of several academic journals. He has also served as president of a number of academic organizations, including the Academy of Financial Services, the Midwest Finance Association, and the Financial Management Association National Honor Society. Professor Gitman earned degrees from Purdue University (B.S. in Industrial Management), the University of Dayton (MBA), and the University of Cincinnati (PhD in Finance).

Carl McDaniel, University of Texas, Arlington
Carl McDaniel’s career has spanned more than 40 years, during which he was the recipient of several awards for outstanding teaching. He was the chair of the University of Texas at Arlington marketing department for 32 year, and now teaches executive MBA courses locally and in China. McDaniel’s research has appeared in such publications as the *Journal of Marketing*, *Journal of Business Research*, *Journal of the Academy of Marketing Science*, and *California Management Review*. He has also authored over 50 textbooks in marketing and business. He has a bachelor’s degree from the University of Arkansas and a master’s degree and doctorate from Arizona State University.

Amit Shah, Frostburg State University
Amit Shah is professor of management and director of the Center for Community Partnerships at Frostburg State University (FSU) in Maryland. He has over 20 years of experience in industry and academia. Dr. Shah has taught a variety of business courses including management, strategic management, and international business. He has published over 60 referreed articles in various journals and published proceedings and has conducted training for various organizations in the area of business and strategy. In his capacity as Center director, he works with various small-to-medium-size organizations — for profit, nonprofit, and government agencies — in organizing management development workshops and training. He has received several awards including Frostburg State University's Outstanding Faculty Service Award, the FSU College of Business's Outstanding Faculty Research Award, and Outstanding SAM Student Chapter Advisor Award. He has also served as president of the Southeastern Chapters of the Decision Sciences Institute and president of the Institute for Operations Research and Management Sciences. When he is not in his classroom or engaged in community service, Dr. Shah enjoys being an entrepreneur serving coffee at Mountain City Coffeehouse and Creamery, which he owns with his wife.

Monique Reece
Monique Reece is the founder and CEO of MarketSmarter, a marketing consulting and training firm that helps companies improve strategy and implement real-time business planning processes to develop a culture of execution. She has more than 20 years of marketing and executive management experience working with both Fortune 100 companies and fast-growing entrepreneurial businesses. Professor Reece formerly served as Executive Vice President at Jones Knowledge and as Director of Global Market Development at Avaya. Monique has served as an Executive Education faculty member at the Daniels College of Business, University of Denver, and as an Adjunct Professor at the Institute for Leadership and Organizational Performance where she taught marketing and customer experience in the Executive MBA program. She has published hundreds of articles

and is the author of four books. Monique is also a frequent speaker for industry conferences such as the American Marketing Association and *Inc. Magazine*.

Linda Koffel, Houston Community College
Linda Koffel has been teaching at Houston Community College. She is a winner of the Consortium of Community Colleges for Innovation, a prestigious NISOD award for teaching. She taught in the Goldman Sachs *10,000 Small Businesses* program; is a certified Ice House Entrepreneurial Program professor; and has her own business. Linda Koffel played a key role in the design and development of cutting-edge marketing and entrepreneurial curriculum at Houston Community College.

Bethann Talsma, Davenport University and Grand Rapids Community College
Bethann Talsma is the founder of Platinum Properties, an income property business that provides housing in Grand Rapids, Michigan. She has more than 15 years of experience managing all operations including property procurement, tenant interaction, project management, and administration. Under her leadership the business has experienced steady growth and increased profits. Bethann also serves as an adjunct instructor at both Grand Rapids Community College and Davenport University where she teaches general business courses and Microsoft Office applications, bringing real-life examples to the classroom. In addition, Bethann facilitates corporate trainings for Microsoft Office and Google applications.

James C. Hyatt, University of The Cumberlands
Professor Hyatt serves the University of the Cumberlands teaching graduate courses for the School of Computer and Information Sciences, Executive Programs. He has served as an Assistant Professor at Fort Hays State University and Ashford University, where he taught Business, Technology and Analytics Courses. He has published in Business, Technology and Leadership journals and serves on International Committees. Professor Hyatt has extensive experience in Business, Technology and Analytics consulting. Professor Hyatt received his Ph.D. in Information Systems Management from Walden University and also holds degrees from Fort Hays State University and Southern Utah University.

Reviewers

Maria Zak Aria, Camden County College
Joseph H. Atallah, Devry Institute of Technology
Herm Baine, Broward Community College
Dennis R. Brode, Sinclair Community College
Harvey Bronstein, Oakland Community College
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M. Bixby Cooper, Michigan State University
Linda Davenport, Klamath Community College
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Carol Rowey, Community College of Rhode Island
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Carolyn Stevenson, Kaplan University
Richard E. T. Strickler, Sr., McLennan Community College
Linda Tancs
Susan Thompson, Palm Beach Community College
David L. Turnipseed, Indiana University-Purdue University Fort Wayne
Maria Vitale, Chaffey College
Valerie Wallingford, Bemidji State University
Ron Weidenfeller, Grand Rapids Community College

1

Understanding Economic Systems and Business

Exhibit 1.1 (Credit: Marco Verch /flickr / Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. How do businesses and not-for-profit organizations help create our standard of living?
2. What are the sectors of the business environment, and how do changes in them influence business decisions?
3. What are the primary features of the world's economic systems, and how are the three sectors of the U.S. economy linked?
4. How do economic growth, full employment, price stability, and inflation indicate a nation's economic health?
5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?
6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?
7. What are the four types of market structure?
8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

EXPLORING BUSINESS CAREERS

Team Rubicon: Disaster Relief and a Sense of Purpose

Accounting for a substantial amount of economic activity in the United States, not-for-profits are an undeniable force in the business world, even though their focus on goals other than profit falls outside the traditional model of a for-profit business. But it is this shift away from a focus on profit that allows them to pursue missions of social improvement and contributions to society as a whole. To be truly effective in a not-for-profit organization, a person must share the organization’s vision.

The vision for Team Rubicon was shaped by its cofounders, Jake Wood and William McNulty, who saw the devastation caused by the Haiti earthquake in 2010 and sprang into action. Both marines, Wood and McNulty knew they could do something to help in this devastating and chaotic situation. Within 24 hours, they enlisted the help of six other military veterans and first responders, gathered donations and supplies from friends and family, and made their way to Haiti to help with disaster relief, and Team Rubicon was born.

Exhibit 1.2 Team Rubicon (Credit: Bureau of Land Management Oregon and Washington/flickr/ Attribution 2.0 Generic (CC BY 2.0))

The organization gets its name from the Rubicon, a river in northern Italy that Julius Caesar and his troops crossed on their epic march to Rome, with the river marking the point of no return. The name underscores the cofounders’ experiences during the Haitian disaster, where despite advice from government officials and other aid organizations not to proceed, their small team crossed into Haiti from the Dominican Republic carrying crucial gear and medical supplies to thousands of earthquake victims.

Seven years later, Team Rubicon’s mission is twofold: to pair the skills and experiences of military veterans with first responders to hit the ground running in any type of disaster and to provide a sense of community and accomplishment to veterans who have served their country proudly but may be struggling as a result of their war experiences.

According to the organization’s mission statement, Team Rubicon seeks to provide veterans three things they sometimes lose after leaving the military: a purpose, gained through disaster relief; a sense of community, built by serving with others; and a feeling of self-worth from recognizing the impact one individual can make when dealing with natural disasters.

Headquartered in the Los Angeles area, Team Rubicon is staffed by more than 60 employees who work in 10 regions around the country, along with more than 40,000 volunteers ready to deploy within 24 hours. Similar to company operations in for-profit organizations, staff positions at Team Rubicon include regional administrators; field operations (including membership and training); marketing, communications, and social media; fundraising and partnership development; finance and accounting; and people operations.

Team Rubicon's staff members bring professional and/or military experience to their daily jobs, but they all share the organization's vision. Many staff members started as volunteers for Team Rubicon while working in for-profit careers, while others took advantage of the organization's strong internship program to become familiar with its mission and focus on disaster relief.

In 2016, Team Rubicon trained 8,000 military veterans and first responders in disaster relief and responded to 46 disasters, which required more than 85,000 volunteer hours. In addition to donations from individuals and corporations, Team Rubicon relies on its partnerships with other organizations, such as Southwest Airlines, which supplies hundreds of free plane tickets each year to fly volunteers to disaster sites.

Team Rubicon actively engages its nationwide community at every level of the organization, from volunteer to board member, and every step of its operation: from training to planning to implementation to seeking donations and volunteers to help with any type of disaster relief. Over the past several years, Team Rubicon has been recognized as one of the top nonprofits to work for by *The NonProfit Times*, based on employee surveys and business partners' input about the organization's work environment.

The not-for-profit world may not be for everyone, but if its growth is any indication within the overall economy, it does appeal to many. With a resolve to assist those in need, including both disaster victims and returning military personnel, Team Rubicon offers opportunities for those interested in nonprofit careers as well as those passionate about helping others.

Sources: Company website, "Our Mission" and "Staff & Board," https://teamrubiconusa.org, accessed May 29, 2017; Mark Hrywna, "2017 NPT Best Nonprofits to Work," *The NonProfit Times,* http://thenonprofittimes.com, accessed May 27, 2017; Mark Hrywna, "2016 NPT Best Nonprofits to Work," *The NonProfit Times,* http://thenonprofittimes.com, accessed May 27, 2017; Kyle Dickman, "The Future of Disaster Relief Isn't the Red Cross," *Outside,* https://www.outsideonline.com, August 25, 2016.

This module provides the basic structures upon which the business world is built: how it is organized, what outside forces influence it, and where it is heading. It also explores how the world's economies and governments shape economic activity. Each day in the United States, thousands of new businesses are born. Only a rare few will become the next Apple, Google, or Amazon. Unfortunately, many others will never see their first anniversary. The survivors are those that understand that change is the one constant in the business environment. Those organizations pay attention to the business environment in which they operate and the trends that affect all businesses and then successfully adapt to those trends. In this module, we will meet many businesses, both large and small, profit and not-for-profit, that prosper because they track trends and use them to identify potential opportunities. This ability to manage change is a critical factor in separating the success stories from the tales of business failure.

We begin our study of business by introducing you to the primary functions of a business, the relationship between risk and profits, and the importance of not-for-profit organizations. We'll also examine the major components of the business environment and how changing demographic, social, political and legal, and competitive factors affect all business organizations. Next, we'll explore how economies provide jobs for workers and also compete with other businesses to create and deliver products to consumers. You will also learn how governments attempt to influence economic activity through policies such as lowering or raising taxes. Next, we discuss how supply and demand determine prices for goods and services. Finally, we conclude by examining key trends in the business environment, economic systems, and the competitive environment.

1.1 The Nature of Business

1. How do businesses and not-for-profit organizations help create our standard of living?

Take a moment to think about the many different types of businesses you come into contact with on a typical day. As you drive to class, you may stop at a gas station that is part of a major national oil company and grab lunch from a fast food chain such as Taco Bell or McDonald's or the neighborhood pizza place. Need more cash? You can do your banking on a smartphone or other device via mobile apps. You don't even have to visit the store anymore: online shopping brings the stores to you, offering everything from clothes to food, furniture, and concert tickets.

A **business** is an organization that strives for a profit by providing goods and services desired by its customers. Businesses meet the needs of consumers by providing medical care, autos, and countless other goods and services. **Goods** are tangible items manufactured by businesses, such as laptops. **Services** are intangible offerings of businesses that can't be held, touched, or stored. Physicians, lawyers, hairstylists, car washes, and airlines all provide services. Businesses also serve other organizations, such as hospitals, retailers, and governments, by providing machinery, goods for resale, computers, and thousands of other items.

Thus, businesses create the goods and services that are the basis of our standard of living. The **standard of living** of any country is measured by the output of goods and services people can buy with the money they have. The United States has one of the highest standards of living in the world. Although several countries, such as Switzerland and Germany, have higher average wages than the United States, their standards of living aren't higher, because prices are so much higher. As a result, the same amount of money buys less in those countries. For example, in the United States, we can buy an Extra Value Meal at McDonald's for less than $5, while in another country, a similar meal might cost as much as $10.

Businesses play a key role in determining our quality of life by providing jobs and goods and services to society. **Quality of life** refers to the general level of human happiness based on such things as life expectancy, educational standards, health, sanitation, and leisure time. Building a high quality of life is a combined effort of businesses, government, and not-for-profit organizations. In 2017, Vienna, Austria, ranked highest in quality of life, followed by Zurich, Switzerland; Auckland, New Zealand; and Munich, Germany. It may come as a surprise that not one of the world's top cities is in the United States: seven of the top 10 locations are in western Europe, two are in Australia/New Zealand, and one is in Canada. At the other end of the scale, Baghdad, Iraq, is the city scoring the lowest on the annual survey.[1] Creating a quality of life is not without risks, however. **Risk** is the potential to lose time and money or otherwise not be able to accomplish an organization's goals. Without enough blood donors, for example, the American Red Cross faces the risk of not meeting the demand for blood by victims of disaster. Businesses such as Microsoft face the risk of falling short of their revenue and profit goals. **Revenue** is the money a company receives by providing services or selling goods to customers. **Costs** are expenses for rent, salaries, supplies, transportation, and many other items that a company incurs from creating and selling goods and services. For example, some of the costs incurred by Microsoft in developing its software include expenses for salaries, facilities, and advertising. If Microsoft has money left over after it pays all costs, it has a **profit**. A company whose costs are greater than revenues shows a loss.

When a company such as Microsoft uses its resources intelligently, it can often increase sales, hold costs down, and earn a profit. Not all companies earn profits, but that is the risk of being in business. In U.S. business today, there is generally a direct relationship between risks and profit: the greater the risks, the greater the potential for profit (or loss). Companies that take too conservative a stance may lose out to more nimble competitors who react quickly to the changing business environment.

Take Sony, for example. The Japanese electronics giant, once a leader with its Walkman music player and Trinitron televisions, steadily lost ground—and profits—over the past two decades to other companies by not embracing new technologies such as the digital music format and flat-panel TV screens. Sony misjudged what the market wanted and stayed with proprietary technologies rather than create cross-platform options for consumers. Apple, at the time an upstart in personal music devices, quickly grabbed the lion’s share of the digital music market with its iPods and iTunes music streaming service. By 2016, Sony restructured its business portfolio and has experienced substantial success with its PlayStation 4 gaming console and original gaming content.[2]

Not-for-Profit Organizations

Not all organizations strive to make a profit. A **not-for-profit organization** is an organization that exists to achieve some goal other than the usual business goal of profit. Charities such as Habitat for Humanity, the United Way, the American Cancer Society, and the World Wildlife Fund are not-for-profit organizations, as are most hospitals, zoos, arts organizations, civic groups, and religious organizations. Over the last 20 years, the number of nonprofit organizations—and the employees and volunteers who work for them—has increased considerably. Government is our largest and most pervasive not-for-profit group. In addition, more than 1.5 million nongovernmental not-for-profit entities operate in the United States today and contribute more than $900 billion annually to the U.S. economy.[3]

Like their for-profit counterparts, these groups set goals and require resources to meet those goals. However, their goals are not focused on profits. For example, a not-for-profit organization’s goal might be feeding the poor, preserving the environment, increasing attendance at the ballet, or preventing drunk driving. Not-for-profit organizations do not compete directly with one another in the same manner as, for example, Ford and Honda, but they do compete for talented employees, people’s limited volunteer time, and donations.

Exhibit 1.3 Rescue boat Following Hurricane Irma affected The island of Puerto Rico, the Kentucky and Haraii National Guard assisted storm victims by donating to disaster relief efforts. Some not-for-profit charities focused aid toward the people of the region, but others delivered care to a different group of sufferers: animals and pets. Although most animal hospitals are not normally a refuge for displaced animals, many facilities opened their doors to pet owners affected by the torrential rains. *Why are tasks such as animal rescue managed primarily through not-for-profit organizations?* (Credit: Hawaii and Kentucky National Guard /flickr /Attribution 2.0 Generic (CC BY))

The boundaries that formerly separated not-for-profit and for-profit organizations have blurred, leading to a greater exchange of ideas between the sectors. As discussed in detail in the ethics chapter, for-profit businesses are now addressing social issues. Successful not-for-profits apply business principles to operate more effectively. Not-for-profit managers are concerned with the same concepts as their colleagues in for-profit companies: developing strategy, budgeting carefully, measuring performance, encouraging innovation, improving productivity, demonstrating accountability, and fostering an ethical workplace environment.

In addition to pursuing a museum’s artistic goals, for example, top executives manage the administrative and business side of the organization: human resources, finance, and legal concerns. Ticket revenues cover a fraction of the museum’s operating costs, so the director spends a great deal of time seeking major donations and memberships. Today’s museum boards of directors include both art patrons and business executives who want to see sound fiscal decision-making in a not-for-profit setting. Therefore, a museum director must walk a fine line between the institution’s artistic mission and financial policies. According to a survey by *The Economist*, over the next several years, major art museums will be looking for new directors, as more than a third of the current ones are approaching retirement.[4]

Factors of Production: The Building Blocks of Business

To provide goods and services, regardless of whether they operate in the for-profit or not-for-profit sector, organizations require inputs in the form of resources called **factors of production**. Four traditional factors of production are common to all productive activity: *natural resources*, *labor (human resources)*, *capital*, and *entrepreneurship*. Many experts now include *knowledge* as a fifth factor, acknowledging its key role in business success. By using the factors of production efficiently, a company can produce more goods and services with the same resources.

Commodities that are useful inputs in their natural state are known as natural resources. They include farmland, forests, mineral and oil deposits, and water. Sometimes natural resources are simply called land, although, as you can see, the term means more than just land. Companies use natural resources in different ways. International Paper Company uses wood pulp to make paper, and Pacific Gas & Electric Company may use water, oil, or coal to produce electricity. Today urban sprawl, pollution, and limited resources have raised questions about resource use. Conservationists, environmentalists, and government bodies are proposing laws to require land-use planning and resource conservation.

Labor, or human resources, refers to the economic contributions of people working with their minds and muscles. This input includes the talents of everyone—from a restaurant cook to a nuclear physicist—who performs the many tasks of manufacturing and selling goods and services.

The tools, machinery, equipment, and buildings used to produce goods and services and get them to the consumer are known as **capital**. Sometimes the term *capital* is also used to mean the money that buys machinery, factories, and other production and distribution facilities. However, because money itself produces nothing, it is not one of the basic inputs. Instead, it is a means of acquiring the inputs. Therefore, in this context, capital does not include money.

Entrepreneurs are the people who combine the inputs of natural resources, labor, and capital to produce goods or services with the intention of making a profit or accomplishing a not-for-profit goal. These people make the decisions that set the course for their businesses; they create products and production processes or develop services. Because they are not guaranteed a profit in return for their time and effort, they must be risk-takers. Of course, if their companies succeed, the rewards may be great.

Today, many individuals want to start their own businesses. They are attracted by the opportunity to be their own boss and reap the financial rewards of a successful firm. Many start their first business from their dorm rooms, such as Mark Zuckerberg of Facebook, or while living at home, so their cost is almost zero. Entrepreneurs include people such as Microsoft cofounder Bill Gates, who was named the richest person in the world in 2017, as well as Google founders Sergey Brin and Larry Page.[5] Many thousands of individuals have started companies that, while remaining small, make a major contribution to the U.S. economy.

CATCHING THE ENTREPRENEURIAL SPIRIT

StickerGiant Embraces Change

Entrepreneurs typically are not afraid to take risks or change the way they do business if it means there is a better path to success. John Fischer of Longmont, Colorado, fits the profile.

The drawn-out U.S. presidential election in 2000 between Bush and Gore inspired Fischer to create a bumper sticker that claimed, “He’s Not My President,” which became a top seller. As a result of this venture, Fischer started an online retail sticker store, which he viewed as possibly the “Amazon of Stickers.” Designing and making stickers in his basement, Fischer’s start-up would eventually become a multimillion-dollar company, recognized in 2017 by *Forbes* as one of its top 25 small businesses.

The StickerGiant online store was successful, supplying everything from sports stickers to ones commemorating rock and roll bands and breweries. By 2011, the business was going strong; however, the entrepreneur decided to do away with the retail store, instead focusing the business on custom orders, which became StickerGiant’s main product.

As the company became more successful and added more employees, Fischer once again looked to make some changes. In 2012 he decided to introduce a concept called open-book management, in which he shares the company’s financials with employees at a weekly meeting. Other topics discussed at the meeting include customer comments and feedback, employee concerns, and colleague appreciation for one another. Fischer believes sharing information about the company’s performance (good or bad) not only allows employees to feel part of the operation, but also empowers them to embrace change or suggest ideas that could help the business expand and flourish.

Innovation is also visible in the technology StickerGiant uses to create miles and miles of custom stickers (nearly 800 miles of stickers in 2016). The manufacturing process involves digital printing and laser-finishing equipment. Fischer says only five other companies worldwide have the laser-finishing equipment StickerGiant uses as part of its operations. Because of the investment in this high-tech equipment, the company can make custom stickers in large quantities overnight and ship them to customers the next day.

This small business continues to evolve with an entrepreneur at the helm who is not afraid of making changes or having fun. In 2016, StickerGiant put together Saul the Sticker Ball, a *Guinness World Records* winner that weighed in at a whopping 232 pounds. Fischer and his employees created Saul when they collected more than 170,000 stickers that had been lying around the office and decided to put them to good use. With $10 million in annual sales and nearly 40 employees, StickerGiant continues to be a successful endeavor for John Fischer and his employees almost two decades after Fischer created his first sticker.

Questions for Discussion

1. How does being a risk-taker help Fischer in his business activities?
2. If you were a small business owner, would you consider sharing the company’s financial data with employees? Explain your reasoning.

Sources: “All About StickerGiant,” https://www.stickergiant.com, accessed May 29, 2017; Bo Burlingham, “Forbes Small Giants 2017: America’s Best Small Companies,” *Forbes,* http://www.forbes.com, May 9, 2017; Karsten Strauss, “Making Money and Breaking Records in the Sticker Business,” *Forbes,* http://www.forbes.com, January 26, 2016; Emilie Rusch, “StickerGiant Does Big Business in Tiny Town of Hygiene,” *Denver Post,* April 19, 2016, http://www.denverpost.com; Eric Peterson, “StickerGiant,” *Company Week,* https://companyweek.com, September 5, 2016.

A number of outstanding managers and noted academics are beginning to emphasize a fifth factor of production—knowledge. **Knowledge** refers to the combined talents and skills of the workforce and has become a primary driver of economic growth. Today’s competitive environment places a premium on knowledge and learning over physical resources. Recent statistics suggest that the number of U.S. **knowledge workers** has doubled over the last 30 years, with an estimated 2 million knowledge job openings annually. Despite the fact that many “routine” jobs have been replaced by automation over the last decade or outsourced to other countries, technology has actually created more jobs that require knowledge and cognitive skills.[6]

CONCEPT CHECK

1. Explain the concepts of revenue, costs, and profit.
2. What are the five factors of production?
3. What is the role of an entrepreneur in society?

1.2 Understanding the Business Environment

2. What are the sectors of the business environment, and how do changes in them influence business decisions?

Businesses do not operate in a vacuum but rather in a dynamic environment that has a direct influence on how they operate and whether they will achieve their objectives. This external business environment is composed of numerous outside organizations and forces that we can group into seven key subenvironments, as **Exhibit 1.4** illustrates: economic, political and legal, demographic, social, competitive, global, and technological. Each of these sectors creates a unique set of challenges and opportunities for businesses.

Business owners and managers have a great deal of control over the internal environment of business, which covers day-to-day decisions. They choose the supplies they purchase, which employees they hire, the products they sell, and where they sell those products. They use their skills and resources to create goods and services that will satisfy existing and prospective customers. However, the external environmental conditions that affect a business are generally beyond the control of management and change constantly. To compete successfully, business owners and managers must continuously study the environment and adapt their businesses accordingly.

Other forces, such as natural disasters, can also have a major impact on businesses. While still in the rebuilding stage after Hurricane Katrina hit in 2005, the U.S. Gulf Coast suffered another disaster in April 2010 as a result of an explosion on the Deepwater Horizon oil-rig, which killed 11 workers and sent more than 3 million barrels of oil into the Gulf of Mexico. This event, which played out for more than 87 days, severely affected the environment, businesses, tourism, and people’s livelihoods. Global oil conglomerate BP, which was responsible for the oil spill, has spent more than $60 billion in response to the disaster and cleanup. Seven years after the explosion, tourism and other businesses are slowly recovering, although scientists are not certain about the long-term environmental consequences of the oil spill.[7]

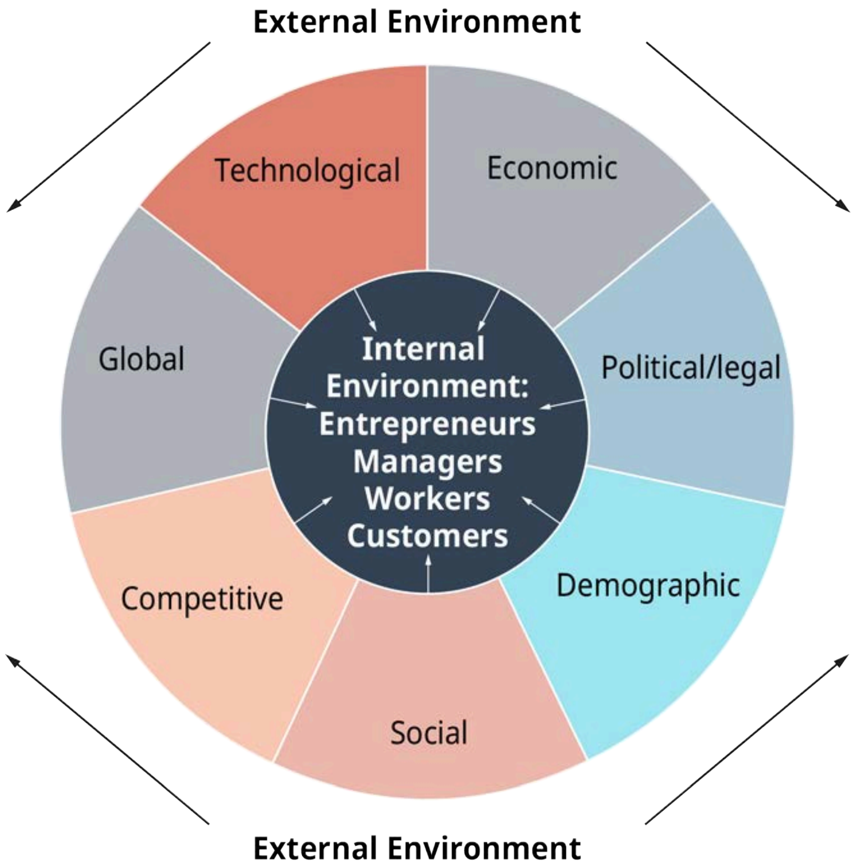

Exhibit 1.4 The Dynamic Business Environment (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

No one business is large or powerful enough to create major changes in the external environment. Thus, managers are primarily adapters to, rather than agents of, change. Global competition is basically an uncontrollable element in the external environment. In some situations, however, a firm can influence external events through its strategies. For example, major U.S. pharmaceutical companies have been successful in getting the Food and Drug Administration (FDA) to speed up the approval process for new drugs.[8] In recent years, the five largest companies in the S&P Index—Google, Facebook, Amazon, Microsoft, and Apple—have spent close to $50 million on lobbying activities in the nation's capital in an effort to help policy makers understand the tech industry and the importance of innovation and an "open" internet.[9] Let's now take a brief look at these varied environmental influences.

Economic Influences

This category is one of the most important external influences on businesses. Fluctuations in the level of economic activity create business cycles that affect businesses and individuals in many ways. When the economy is growing, for example, unemployment rates are low, and income levels rise. Inflation and interest rates are other areas that change according to economic activity. Through the policies it sets, such as taxes and interest rate levels, a government attempts to stimulate or curtail the level of economic activity. In addition, the forces of supply and demand determine how prices and quantities of goods and services behave in a free market.

Political and Legal Influences

The political climate of a country is another critical factor for managers to consider in day-to-day business operations. The amount of government activity, the types of laws it passes, and the general political stability of a government are three components of political climate. For example, a multinational company such as General Electric will evaluate the political climate of a country before deciding to locate a plant there. Is the government stable, or might a coup disrupt the country? How restrictive are the regulations for foreign businesses, including foreign ownership of business property and taxation? Import tariffs, quotas, and export restrictions also must be taken into account.

In the United States, laws passed by Congress and the many regulatory agencies cover such areas as competition, minimum wages, environmental protection, worker safety, and copyrights and patents. For example, Congress passed the Telecommunications Act of 1996 to deregulate the telecommunications industry. As a result, competition increased and new opportunities arose as traditional boundaries between service providers blurred. Today the dramatic growth in mobile technology has changed the focus of telecommunications, which now faces challenges related to broadband access and speed, content streaming, and much-needed improvements in network infrastructure to address ever-increasing data transmissions.[10]

Federal agencies play a significant role in business operations. When Pfizer wants to bring a new medication for heart disease to market, it must follow the procedures set by the Food and Drug Administration for testing and clinical trials and secure FDA approval. Before issuing stock, Pfizer must register the securities with the Securities and Exchange Commission. The Federal Trade Commission will penalize Pfizer if its advertisements promoting the drug’s benefits are misleading. These are just a few ways the political and legal environment affect business decisions.

States and local governments also exert control over businesses—imposing taxes, issuing corporate charters and business licenses, setting zoning ordinances, and similar regulations. We discuss the legal environment in greater detail in a separate appendix.

Demographic Factors

Demographic factors are an uncontrollable factor in the business environment and extremely important to managers. **Demography** is the study of people’s vital statistics, such as their age, gender, race and ethnicity, and location. Demographics help companies define the markets for their products and also determine the size and composition of the workforce. You’ll encounter demographics as you continue your study of business.

Demographics are at the heart of many business decisions. Businesses today must deal with the unique shopping preferences of different generations, which each require marketing approaches and goods and services targeted to their needs. For example, the more than 75 million members of the millennial generation were born between 1981 and 1997. In 2017 they surpassed baby boomers as America’s largest generation.[11] The marketing impact of millennials continues to be immense. These are technologically savvy and prosperous young people, with hundreds of billions of dollars to spend. And spend they do—freely, even though they haven’t yet reached their peak income and spending years.[12] Other age groups, such as Generation X—people born between 1965 and 1980—and the baby boomers—born between 1946 and 1964—have their own spending patterns. Many boomers nearing retirement have money and are willing to spend it on their health, their comforts, leisure pursuits, and cars. As the population ages, businesses are offering more products that appeal to middle-aged and senior markets.[13]

In addition, minorities represent more than 38 percent of the total population, with immigration bringing millions of new residents to the country over the past several decades. By 2060 the U.S. Census Bureau projects the minority population to increase to 56 percent of the total U.S. population.[14] Companies recognize the value of hiring a diverse workforce that reflects our society. Minorities' buying power has increased significantly as well, and companies are developing products and marketing campaigns that target different ethnic groups.

Social Factors

Social factors—our attitudes, values, ethics, and lifestyles—influence what, how, where, and when people purchase products or services. They are difficult to predict, define, and measure because they can be very subjective. They also change as people move through different life stages. People of all ages have a broader range of interests, defying traditional consumer profiles. They also experience a "poverty of time" and seek ways to gain more control over their time. Changing roles have brought more women into the workforce. This development is increasing family incomes, heightening demand for time-saving goods and services, changing family shopping patterns, and impacting individuals' ability to achieve a work-life balance. In addition, a renewed emphasis on ethical behavior within organizations at all levels of the company has managers and employees alike searching for the right approach when it comes to gender inequality, sexual harassment, and other social behaviors that impact the potential for a business's continued success.

MANAGING CHANGE

Balancing Comes Easy at H&R Block

In an industry driven by deadlines and details, it's hard to imagine striking a balance between work and everyday life for full-time employees and seasonal staff. Fortunately, the management team at H&R Block not only believes in maintaining a strong culture, it also tries to offer flexibility to its more than 70,000 employees and seasonal workers in 12,000 retail offices worldwide.

Based in Kansas City, Missouri, and built on a culture of providing exceptional customer service, H&R Block was recently named the top U.S. business with the best work-life balance by online job search site Indeed. Analyzing more than 10 million company reviews by employees, Indeed researchers identified the top 20 firms with the best work-life balance. H&R Block headed the 2017 list, followed by mortgage lender Network Capital Funding Corporation, fast food chain In-N-Out Burger, Texas food retailer H-E-B, and health services company Kaiser Permanente, among others.

According to Paul Wolfe, Indeed's senior vice president of human resources, empathy on the part of organizations is a key factor in helping employees achieve balance. Wolfe says companies that demonstrate empathy and work diligently to provide personal time for all employees tend to take the top spots on the work-life balance list. "Comments we have seen from employee reviews for these companies indicate 'fair' and 'flexible work environments,'" he says. Surprisingly, none of the tech companies known for their generous work perks made the top 20 list in 2017.

In this 24/7 world, when no one is far from a text or tweet, finding time for both family and work can be difficult, especially in the tax services industry, which is so schedule driven for a good part of the year. Making a commitment to help workers achieve a healthy work-life balance not only helps its employees, but it also helps H&R Block retain workers in a tight labor market where individuals continue to have choices when it comes to where and for whom they want to work.

Questions for Discussion

1. How does management's support of employee work-life balance help the company's bottom line?
2. What can other organizations learn from H&R Block when it comes to offering employee perks that encourage personal time for workers even during the busy tax season?

Sources: "Career Opportunities," https://www.hrblock.com, accessed May 25, 2017; "About Us," http://newsroom.hrblock.com, accessed May 25, 2017; Abigail Hess, "The 20 Best Companies for Work-Life Balance," *CNBC,* http://www.cnbc.com, May 4, 2017; Kristen Bahler, "The 20 Best Companies for Work-Life Balance," *Money,* http://time.com, April 20, 2017; Rachel Ritlop, "3 Benefits Companies Can Provide to Boost Work-Life Balance," *Forbes,* http://www.forbes.com, January 30, 2017.

Technology

The application of technology can stimulate growth under capitalism or any other economic system. **Technology** is the application of science and engineering skills and knowledge to solve production and organizational problems. New equipment and software that improve productivity and reduce costs can be among a company's most valuable assets. **Productivity** is the amount of goods and services one worker can produce. Our ability as a nation to maintain and build wealth depends in large part on the speed and effectiveness with which we use technology—to invent and adapt more efficient equipment to improve manufacturing productivity, to develop new products, and to process information and make it instantly available across the organization and to suppliers and customers.

Many U.S. businesses, large and small, use technology to create change, improve efficiencies, and streamline operations. For example, advances in cloud computing provide businesses with the ability to access and store data without running applications or programs housed on a physical computer or server in their offices. Such applications and programs can now be accessed through the internet. Mobile technology allows businesses to communicate with employees, customers, suppliers, and others at the swipe of a tablet or smartphone screen. Robots help businesses automate repetitive tasks that free up workers to focus on more knowledge-based tasks critical to business operations.[15]

CONCEPT CHECK

1. Define the components of the internal and the external business environments.
2. What factors within the economic environment affect businesses?
3. Why do demographic shifts and technological developments create both challenges and new opportunities for business?

1.3 How Business and Economics Work

3. What are the primary features of the world's economic systems, and how are the three sectors of the U.S. economy linked?

A business's success depends in part on the economic systems of the countries where it is located and where its sells its products. A nation's **economic system** is the combination of policies, laws, and choices made by its government to establish the systems that determine what goods and services are produced and how they are allocated. **Economics** is the study of how a society uses scarce resources to produce and distribute goods and services. The resources of a person, a firm, or a nation are limited. Hence, economics is the study of choices—what people, firms, or nations choose from among the available resources. Every economy is concerned with what types and amounts of goods and services should be produced, how they should be produced, and for whom. These decisions are made by the marketplace, the government, or both. In the United States, the government and the free-market system together guide the economy.

You probably know more about economics than you realize. Every day, many news stories deal with economic matters: a union wins wage increases at General Motors, the Federal Reserve Board lowers interest rates, Wall Street has a record day, the president proposes a cut in income taxes, consumer spending rises as the economy grows, or retail prices are on the rise, to mention just a few examples.

Global Economic Systems

Businesses and other organizations operate according to the *economic systems* of their home countries. Today the world's major economic systems fall into two broad categories: free market, or capitalism; and planned economies, which include communism and socialism. However, in reality many countries use a mixed market system that incorporates elements from more than one economic system.

The major differentiator among economic systems is whether the government or individuals decide:

- How to allocate limited resources—the factors of production—to individuals and organizations to best satisfy unlimited societal needs
- What goods and services to produce and in what quantities
- How and by whom these goods and services are produced
- How to distribute goods and services to consumers

Managers must understand and adapt to the economic system or systems in which they operate. Companies that do business internationally may discover that they must make changes in production and selling methods to accommodate the economic system of other countries. **Table 1.1** summarizes key factors of the world's economic systems.

The Basic Economic Systems of the World				
	Capitalism	Communism	Socialism	Mixed Economy
Ownership of Business	Businesses are privately owned with minimal government ownership or interference.	Government owns all or most enterprises.	Basic industries such as railroads and utilities are owned by government. Very high taxation as government redistributes income from successful private businesses and entrepreneurs.	Private ownership of land and businesses but government control of some enterprises. The private sector is typically large
Control of Markets	Complete freedom of trade. No or little government control.	Complete government control of markets.	Some markets are controlled, and some are free. Significant central-government planning. State enterprises are managed by bureaucrats. These enterprises are rarely profitable.	Some markets, such as nuclear energy and the post office, are controlled or highly regulated.
Worker Incentives	Strong incentive to work and innovate because profits are retained by owners.	No incentive to work hard or produce quality products.	Private-sector incentives are the same as capitalism, and public-sector incentives are the same as in a planned economy.	Private-sector incentives are the same as capitalism. Limited incentives in the public sector.
Management of Enterprises	Each enterprise is managed by owners or professional managers with little government interference.	Centralized management by the government bureaucracy. Little or no flexibility in decision-making at the factory level.	Significant government planning and regulation. Bureaucrats run government enterprises.	Private-sector management similar to capitalism. Public sector similar to socialism.

Table 1.1

The Basic Economic Systems of the World				
	Capitalism	Communism	Socialism	Mixed Economy
Forecast for 2020	Continued steady growth.	No growth and perhaps disappearance.	Stable with probable slight growth.	Continued growth.
Examples	United States	Cuba, North Korea	Finland, India, Israel	Great Britain, France, Sweden, Canada

Table 1.1

Capitalism

In recent years, more countries have shifted toward free-market economic systems and away from planned economies. Sometimes, as was the case of the former East Germany, the transition to capitalism was painful but fairly quick. In other countries, such as Russia, the movement has been characterized by false starts and backsliding. **Capitalism**, also known as the *private enterprise system*, is based on competition in the marketplace and private ownership of the factors of production (resources). In a competitive economic system, a large number of people and businesses buy and sell products freely in the marketplace. In pure capitalism, all the factors of production are owned privately, and the government does not try to set prices or coordinate economic activity.

A capitalist system guarantees certain economic rights: the right to own property, the right to make a profit, the right to make free choices, and the right to compete. The right to own property is central to capitalism. The main incentive in this system is profit, which encourages entrepreneurship. Profit is also necessary for producing goods and services, building manufacturing plants, paying dividends and taxes, and creating jobs. The freedom to choose whether to become an entrepreneur or to work for someone else means that people have the right to decide what they want to do on the basis of their own drive, interest, and training. The government does not create job quotas for each industry or give people tests to determine what they will do.

Competition is good for both businesses and consumers in a capitalist system. It leads to better and more diverse products, keeps prices stable, and increases the efficiency of producers. Companies try to produce their goods and services at the lowest possible cost and sell them at the highest possible price. But when profits are high, more businesses enter the market to seek a share of those profits. The resulting competition among companies tends to lower prices. Companies must then find new ways of operating more efficiently if they are to keep making a profit—and stay in business.

Exhibit 1.5 McDonald's China Since joining the World Trade Organization in 2001, China has continued to embrace tenets of capitalism and grow its economy. China is the world's largest producer of mobile phones, PCs, and tablets, and the country's over one billion people constitute a gargantuan market. The explosion of McDonald's and KFC franchises epitomizes the success of American-style capitalism in China, and Beijing's bid to host the 2022 Winter Olympics is a symbol of economic openness. This McCafe is an example of changing Western products to suit Chinese tastes. This is an example of changing Western products to suit Chinese tastes. *Do you think China's capitalistic trend can continue to thrive under the ruling Chinese Communist Party that opposes workers' rights, free speech, and democracy?* (Credit: Marku Kudjerski/ flickr/ Attribution 2.0 Generic (CC BY 2.0)

Communism

The complete opposite of capitalism is **communism**. In a communist economic system, the government owns virtually all resources and controls all markets. Economic decision-making is centralized: the government, rather than the competitive forces in the marketplace, decides what will be produced, where it will be produced, how much will be produced, where the raw materials and supplies will come from, who will get the output, and what the prices will be. This form of centralized economic system offers little if any choice to a country's citizens. Early in the 20th century, countries that chose communism, such as the former Soviet Union and China, believed that it would raise their standard of living. In practice, however, the tight controls over most aspects of people's lives, such as what careers they can choose, where they can work, and what they can buy, led to lower productivity. Workers had no reasons to work harder or produce quality goods, because there were no rewards for excellence. Errors in planning and resource allocation led to shortages of even basic items.

These factors were among the reasons for the 1991 collapse of the Soviet Union into multiple independent nations. Recent reforms in Russia, China, and most of the eastern European nations have moved these economies toward more capitalistic, market-oriented systems. North Korea and Cuba are the best remaining examples of communist economic systems. Time will tell whether Cuba takes small steps toward a market economy now that the United States reestablished diplomatic relations with the island country a few years ago.[16]

Socialism

Socialism is an economic system in which the basic industries are owned by the government or by the private sector under strong government control. A socialist state controls critical, large-scale industries such as transportation, communications, and utilities. Smaller businesses and those considered less critical, such as retail, may be privately owned. To varying degrees, the state also determines the goals of businesses, the prices and selection of goods, and the rights of workers. Socialist countries typically provide their citizens with a higher level of services, such as health care and unemployment benefits, than do most capitalist countries. As a result, taxes and unemployment may also be higher in socialist countries. For example, in 2017, the top individual tax rate in France was 45 percent, compared to 39.6 percent in the United States. With both countries electing new presidents in 2017, tax cuts may be a campaign promise that both President Macron and President Trump take on as part of their overall economic agendas in the coming years.[17]

Many countries, including the United Kingdom, Denmark, India, and Israel, have socialist systems, but the systems vary from country to country. In Denmark, for example, most businesses are privately owned and operated, but two-thirds of the population is sustained by the state through government welfare programs.

Mixed Economic Systems

Pure capitalism and communism are extremes; real-world economies fall somewhere between the two. The U.S. economy leans toward pure capitalism, but it uses government policies to promote economic stability and growth. Also, through policies and laws, the government transfers money to the poor, the unemployed, and the elderly or disabled. American capitalism has produced some very powerful organizations in the form of large corporations, such as General Motors and Microsoft. To protect smaller firms and entrepreneurs, the government has passed legislation that requires that the giants compete fairly against weaker competitors.

Canada, Sweden, and the UK, among others, are also called **mixed economies**; that is, they use more than one economic system. Sometimes, the government is basically socialist and owns basic industries. In Canada, for example, the government owns the communications, transportation, and utilities industries, as well as some of the natural-resource industries. It also provides health care to its citizens. But most other activity is carried on by private enterprise, as in a capitalist system. In 2016, UK citizens voted for Britain to leave the European Union, a move that will take two or more years to finalize. It is too early to tell what impact the Brexit decision will have on the UK economy and other economies around the world.[18]

The few factors of production owned by the government in a mixed economy include some public lands, the postal service, and some water resources. But the government is extensively involved in the economic system through taxing, spending, and welfare activities. The economy is also mixed in the sense that the country tries to achieve many social goals—income redistribution and retirement pensions, for example—that may not be attempted in purely capitalist systems.

Macroeconomics and Microeconomics

The state of the economy affects both people and businesses. How you spend your money (or save it) is a personal economic decision. Whether you continue in school and whether you work part-time are also economic decisions. Every business also operates within the economy. Based on their economic expectations, businesses decide what products to produce, how to price them, how many people to employ, how much to pay these employees, how much to expand the business, and so on.

Economics has two main subareas. **Macroeconomics** is the study of the economy as a whole. It looks at *aggregate* data for large groups of people, companies, or products considered as a whole. In contrast, **microeconomics** focuses on individual parts of the economy, such as households or firms.

Both *macroeconomics* and *microeconomics* offer a valuable outlook on the economy. For example, Ford might use both to decide whether to introduce a new line of vehicles. The company would consider such macroeconomic factors as the national level of personal income, the unemployment rate, interest rates, fuel costs, and the national level of sales of new vehicles. From a microeconomic viewpoint, Ford would judge consumer demand for new vehicles versus the existing supply, competing models, labor and material costs and availability, and current prices and sales incentives.

Economics as a Circular Flow

Another way to see how the sectors of the economy interact is to examine the **circular flow** of inputs and outputs among households, businesses, and governments as shown in **Exhibit 1.6**. Let's review the exchanges by following the red circle around the inside of the diagram. Households provide inputs (natural resources, labor, capital, entrepreneurship, knowledge) to businesses, which convert these inputs into outputs (goods and services) for consumers. In return, households receive income from rent, wages, interest, and ownership profits (blue circle). Businesses receive revenue from consumer purchases of goods and services.

The other important exchange in **Exhibit 1.6** takes place between governments (federal, state, and local) and both households and businesses. Governments supply many types of publicly provided goods and services (highways, schools, police, courts, health services, unemployment insurance, social security) that benefit consumers and businesses. Government purchases from businesses also contribute to business revenues. When a construction firm repairs a local stretch of state highway, for example, government pays for the work. As the diagram shows, government receives taxes from households and businesses to complete the flow.

Changes in one flow affect the others. If government raises taxes, households have less to spend on goods and services. Lower consumer spending causes businesses to reduce production, and economic activity declines; unemployment may rise. In contrast, cutting taxes can stimulate economic activity. Keep the circular flow in mind as we continue our study of economics. The way economic sectors interact will become more evident as we explore macroeconomics and microeconomics.

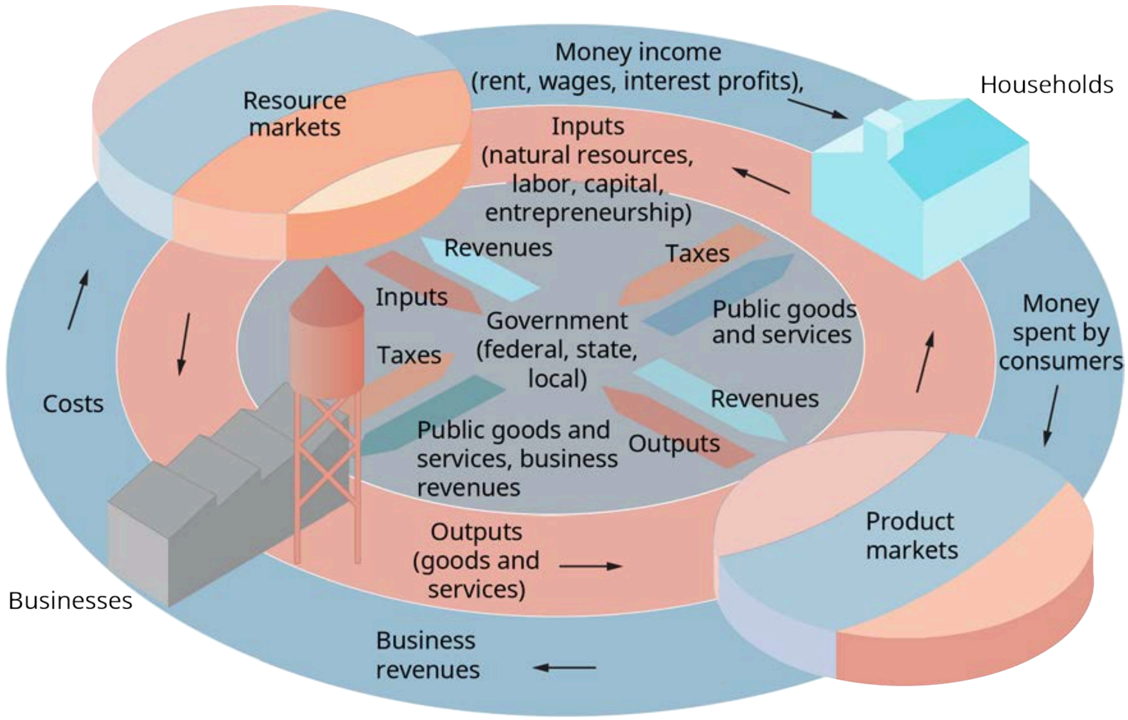

Exhibit 1.6 Economics as a Circular Flow

CONCEPT CHECK

1. What is economics, and how can you benefit from understanding basic economic concepts?
2. Compare and contrast the world’s major economic systems. Why is capitalism growing, communism declining, and socialism still popular?
3. What is the difference between macroeconomics and microeconomics?

1.4 Macroeconomics: The Big Picture

4. How do economic growth, full employment, price stability, and inflation indicate a nation’s economic health?

Have you ever looked at CNN’s *Headline News* on a mobile device or turned on the radio and heard something like, “Today the Labor Department reported that for the second straight month unemployment declined”? Statements like this are macroeconomic news. Understanding the national economy and how changes in government policies affect households and businesses is a good place to begin our study of economics.

Let’s look first at macroeconomic goals and how they can be met. The United States and most other countries have three main macroeconomic goals: economic growth, full employment, and price stability. A nation’s economic well-being depends on carefully defining these goals and choosing the best economic policies for achieving them.

Striving for Economic Growth

Perhaps the most important way to judge a nation’s economic health is to look at its production of goods and services. The more the nation produces, the higher its standard of living. An increase in a nation’s output of goods and services is **economic growth**.

The most basic measure of economic growth is the **gross domestic product (GDP)**. GDP is the total market value of all final goods and services produced within a nation’s borders each year. The Bureau of Labor Statistics publishes quarterly GDP figures that can be used to compare trends in national output. When GDP rises, the economy is growing.

The rate of growth in real GDP (GDP adjusted for inflation) is also important. Recently, the U.S. economy has been growing at a slow but steady rate of between 3 and 4 percent annually. This growth rate has meant a steady increase in the output of goods and services and relatively low unemployment. When the growth rate slides toward zero, the economy begins to stagnate and decline.

One country that continues to grow more rapidly than most is China, whose GDP has been growing at 6 to 7 percent per year. Today few things in the global marketplace are not or cannot be made in China. The primary contributor to China’s rapid growth has been technology. For example, most tablets and laptops are manufactured in China.

The level of economic activity is constantly changing. These upward and downward changes are called **business cycles**. Business cycles vary in length, in how high or low the economy moves, and in how much the economy is affected. Changes in GDP trace the patterns as economic activity expands and contracts. An increase in business activity results in rising output, income, employment, and prices. Eventually, these all peak, and output, income, and employment decline. A decline in GDP that lasts for two consecutive quarters (each a three-month period) is called a **recession**. It is followed by a recovery period when economic activity once again increases. The most recent recession began in December 2007 and ended in June 2009.

Businesses must monitor and react to the changing phases of business cycles. When the economy is growing, companies often have a difficult time hiring good employees and finding scarce supplies and raw materials. When a recession hits, many firms find they have more capacity than the demand for their goods and services requires. During the most recent recession, many businesses operated at substantially lower than capacity. When plants use only part of their capacity, they operate inefficiently and have higher costs per unit produced. Let’s say that Mars Corp. has a huge plant that can produce one million Milky Way candy bars a day, but because of a recession Mars can sell only half a million candy bars a day. The plant uses large, expensive machines. Producing Milky Ways at 50 percent capacity does not efficiently utilize Mars’s investment in its plant and equipment.

Keeping People on the Job

Another macroeconomic goal is **full employment**, or having jobs for all who want to and can work. Full employment doesn’t actually mean 100 percent employment. Some people choose not to work for personal reasons (attending school, raising children) or are temporarily unemployed while they wait to start a new job. Thus, the government defines full employment as the situation when about 94 to 96 percent of those available to work actually have jobs. During the 2007–2009 recession in the United States, the unemployment rate peaked at 10 percent in October 2009. Today, that rate hovers at about 4 percent.[19]

Maintaining low unemployment levels is of concern not just to the United States but also to countries around the world. For example, high youth unemployment rates (for workers 25 years of age and younger) in Spain, Italy, and Greece continue to cause protests in these European countries as elected officials struggle with how to turn around their respective economies and put more people, particularly young people, back to work. The UK's impending exit from the European Union may also have an effect on unemployment rates, as global companies move jobs out of Britain to central European countries such as Poland.[20]

Measuring Unemployment

To determine how close we are to full employment, the government measures the **unemployment rate**. This rate indicates the percentage of the total labor force that is not working but is actively looking for work. It excludes "discouraged workers," those not seeking jobs because they think no one will hire them. Each month the U.S. Department of Labor releases statistics on employment. These figures help us understand how well the economy is doing.

Types of Unemployment

Economists classify unemployment into four types: frictional, structural, cyclical, and seasonal. The categories are of small consolation to someone who is unemployed, but they help economists understand the problem of unemployment in our economy.

Frictional unemployment is short-term unemployment that is not related to the business cycle. It includes people who are unemployed while waiting to start a better job, those who are reentering the job market, and those entering for the first time, such as new college graduates. This type of unemployment is always present and has little impact on the economy.

Structural unemployment is also unrelated to the business cycle but is involuntary. It is caused by a mismatch between available jobs and the skills of available workers in an industry or a region. For example, if the birthrate declines, fewer teachers will be needed. Or the available workers in an area may lack the skills that employers want. Retraining and skill-building programs are often required to reduce structural unemployment.

Cyclical unemployment, as the name implies, occurs when a downturn in the business cycle reduces the demand for labor throughout the economy. In a long recession, cyclical unemployment is widespread, and even people with good job skills can't find jobs. The government can partly counteract cyclical unemployment with programs that boost the economy.

In the past, cyclical unemployment affected mainly less-skilled workers and those in heavy manufacturing. Typically, they would be rehired when economic growth increased. Since the 1990s, however, competition has forced many American companies to downsize so they can survive in the global marketplace. These job reductions affected workers in all categories, including middle management and other salaried positions. Firms continue to reevaluate workforce requirements and downsize to stay competitive to compete with Asian, European, and other U.S. firms. After a strong rebound from the global recession of 2007–2009, when the auto industry slashed more than 200,000 hourly and salaried workers from their payrolls, the automakers are now taking another close look at the size of their global workforces. For example, as sales steadily rose after the recession, Ford Motor Company's workforce in North America increased by 25 percent over the past five years. As car sales plateaued in 2017, the company recently announced it would cut approximately 10 percent of its global workforce in an effort to reduce costs, boost profits, and increase its stock value for shareholders.[21]

The last type is **seasonal unemployment**, which occurs during specific times of the year in certain industries.

Employees subject to seasonal unemployment include retail workers hired for the holiday shopping season, lettuce pickers in California, and restaurant employees in ski country during the summer.

Keeping Prices Steady

The third macroeconomic goal is to keep overall prices for goods and services fairly steady. The situation in which the average of all prices of goods and services is rising is called **inflation**. Inflation's higher prices reduce **purchasing power**, the value of what money can buy. Purchasing power is a function of two things: inflation and income. If incomes rise at the same rate as inflation, there is no change in purchasing power. If prices go up but income doesn't rise or rises at a slower rate, a given amount of income buys less, and purchasing power falls. For example, if the price of a basket of groceries rises from $30 to $40 but your salary remains the same, you can buy only 75 percent as many groceries ($30 ÷ $40) for $30. Your purchasing power declines by 25 percent ($10 ÷ $40). If incomes rise at a rate faster than inflation, then purchasing power increases. So you can, in fact, have rising purchasing power even if inflation is increasing. Typically, however, inflation rises faster than incomes, leading to a decrease in purchasing power.

Inflation affects both personal and business decisions. When prices are rising, people tend to spend more—before their purchasing power declines further. Businesses that expect inflation often increase their supplies, and people often speed up planned purchases of cars and major appliances.

From the early 2000s to April 2017, inflation in the United States was very low, in the 0.1 to 3.8 percent range; for 2016 it was 1.3 percent. For comparison, in the 1980s, the United States had periods of inflation in the 12 to 13 percent range.[22] Some nations have had high double- and even triple-digit inflation in recent years. As of early 2017, the monthly inflation rate in Venezuela was an astounding 741 percent, followed by the African country of South Sudan at 273 percent.[23]

Exhibit 1.7 Nespresso Buyers of Nespresso coffee, KitKat chocolate bars, and Purina pet food are paying more for these items as global food giant Nestlé raises prices. Increasing input costs, such as costs of raw materials, have been hard on food businesses, raising the price of production, packaging, and transportation. *How might fluctuations in the producer price index (PPI) affect the consumer price index (CPI) and why?* (Credit: Kārlis Dambrāns/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Types of Inflation

There are two types of inflation. **Demand-pull inflation** occurs when the demand for goods and services is greater than the supply. Would-be buyers have more money to spend than the amount needed to buy available goods and services. Their demand, which exceeds the supply, tends to pull prices up. This situation is sometimes described as “too much money chasing too few goods.” The higher prices lead to greater supply, eventually creating a balance between demand and supply.

Cost-push inflation is triggered by increases in production costs, such as expenses for materials and wages. These increases push up the prices of final goods and services. Wage increases are a major cause of cost-push inflation, creating a “wage-price spiral.” For example, assume the United Auto Workers union negotiates a three-year labor agreement that raises wages 3 percent per year and increases overtime pay. Carmakers will then raise car prices to cover their higher labor costs. Also, the higher wages will give autoworkers more money to buy goods and services, and this increased demand may pull up other prices. Workers in other industries will demand higher wages to keep up with the increased prices, and the cycle will push prices even higher.

How Inflation Is Measured

The rate of inflation is most commonly measured by looking at changes in the **consumer price index (CPI)**, an index of the prices of a “market basket” of goods and services purchased by typical urban consumers. It is published monthly by the Department of Labor. Major components of the CPI, which are weighted by importance, are food and beverages, clothing, transportation, housing, medical care, recreation, and education. There are special indexes for food and energy. The Department of Labor collects about 80,000 retail price quotes and 5,000 housing rent figures to calculate the CPI.

The CPI sets prices in a base period at 100. The base period, which now is 1982–1984, is chosen for its price stability. Current prices are then expressed as a percentage of prices in the base period. A rise in the CPI means prices are increasing. For example, the CPI was 244.5 in April 2017, meaning that prices more than doubled since the 1982–1984 base period.

Changes in wholesale prices are another important indicator of inflation. The **producer price index (PPI)** measures the prices paid by producers and wholesalers for various commodities, such as raw materials, partially finished goods, and finished products. The PPI, which uses 1982 as its base year, is actually a family of indexes for many different product categories, including crude goods (raw materials), intermediate goods (which become part of finished goods), and finished goods. For example, the PPI for finished goods was 197.7 in April 2017, a 3.9-point increase, and for chemicals was 106.5, up 3.8 points since April 2016. Examples of other PPI indexes include processed foods, lumber, containers, fuels and lubricants, metals, and construction. Because the PPI measures prices paid by producers for raw materials, energy, and other commodities, it may foreshadow subsequent price changes for businesses and consumers.

The Impact of Inflation

Inflation has several negative effects on people and businesses. For one thing, inflation penalizes people who live on fixed incomes. Let’s say that a couple receives $2,000 a month retirement income beginning in 2018. If inflation is 10 percent in 2019, then the couple can buy only about 91 percent (100 ÷ 110) of what they could purchase in 2018. Similarly, inflation hurts savers. As prices rise, the real value, or purchasing power, of a nest egg of savings deteriorates.

CONCEPT CHECK

1. What is a business cycle? How do businesses adapt to periods of contraction and expansion?
2. Why is full employment usually defined as a target percentage below 100 percent?
3. What is the difference between demand-pull and cost-push inflation?

1.5 Achieving Macroeconomic Goals

5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?

To reach macroeconomic goals, countries must often choose among conflicting alternatives. Sometimes political needs override economic needs. For example, bringing inflation under control may call for a politically difficult period of high unemployment and low growth. Or, in an election year, politicians may resist raising taxes to curb inflation. Still, the government must try to guide the economy to a sound balance of growth, employment, and price stability. The two main tools it uses are monetary policy and fiscal policy.

Monetary Policy

Monetary policy refers to a government's programs for controlling the amount of money circulating in the economy and interest rates. Changes in the money supply affect both the level of economic activity and the rate of inflation. The **Federal Reserve System (the Fed)**, the central banking system of the United States, prints money and controls how much of it will be in circulation. The money supply is also controlled by the Fed's regulation of certain bank activities.

When the Fed increases or decreases the amount of money in circulation, it affects interest rates (the cost of borrowing money and the reward for lending it). The Fed can change the interest rate on money it lends to banks to signal the banking system and financial markets that it has changed its monetary policy. These changes have a ripple effect. Banks, in turn, may pass along this change to consumers and businesses that receive loans from the banks. If the cost of borrowing increases, the economy slows because interest rates affect consumer and business decisions to spend or invest. The housing industry, business, and investments react most to changes in interest rates.

As a result of the 2007–2009 recession and the global financial crisis that ensued, the Fed dropped the federal funds rate—the interest rate charged on overnight loans between banks—to 0 percent in December 2008 and kept the rate at zero until December 2015, when it raised the rate to 0.25 percent. This decision marked the first increase in the federal-funds rate since June 2006, when the federal funds rate was 5.25 percent. As the U.S. economy continues to show a slow but steady expansion, the Fed subsequently increased the federal funds rate to a range of 0.75 to 1 percent in March 2017. As expected, this change has a ripple effect: the regional Federal Reserve Banks increase the discount rate they charge commercial banks for short-term loans, many commercial banks raise the interest rates they charge their customers, and credit card companies increase the annual percentage rate (APR) they charge consumers on their credit card balances.[24]

As you can see, the Fed can use monetary policy to contract or expand the economy. With **contractionary policy**, the Fed restricts, or tightens, the money supply by selling government securities or raising interest rates. The result is slower economic growth and higher unemployment. Thus, contractionary policy reduces spending and, ultimately, lowers inflation. With **expansionary policy**, the Fed increases, or loosens, growth in the money supply. An expansionary policy stimulates the economy. Interest rates decline, so business and consumer spending go up. Unemployment rates drop as businesses expand. But increasing the money supply also has a negative side: more spending pushes prices up, increasing the inflation rate.

Exhibit 1.8 Powell As chair of the Board of Governors of the Federal Reserve System, Jerome (Jay) Powell is considered the face of U.S. monetary policy. Powell took over the chair in February 2018 from Janet Yellen, the first woman ever to be appointed Fed chair. *What are the responsibilities of the chair of the Board of Governors of the Federal Reserve System?* (Credit: Federalreserve/ flickr/ US Government Works)

Fiscal Policy

The other economic tool used by the government is **fiscal policy**, its program of taxation and spending. By cutting taxes or by increasing spending, the government can stimulate the economy. Look again at **Exhibit 1.6**. The more government buys from businesses, the greater the business revenues and output. Likewise, if consumers or businesses have to pay less in taxes, they will have more income to spend for goods and services. Tax policies in the United States therefore affect business decisions. High corporate taxes can make it harder for U.S. firms to compete with companies in countries with lower taxes. As a result, companies may choose to locate facilities overseas to reduce their tax burden.

Nobody likes to pay taxes, although we grudgingly accept that we have to. Although most U.S. citizens complain that they are overtaxed, we pay lower taxes per capita (per person) than citizens in many countries similar to ours. In addition, our taxes represent a lower percentage of gross income and GDP compared to most countries.

Taxes are, of course, the major source of revenue for our government. Every year, the president prepares a budget for the coming year based upon estimated revenues and expenditures. Congress receives the president’s report and recommendations and then, typically, debates and analyzes the proposed budget for several months. The president’s original proposal is always modified in numerous ways. **Exhibit 1.9** shows the sources of revenue and expenses for the U.S. budget.

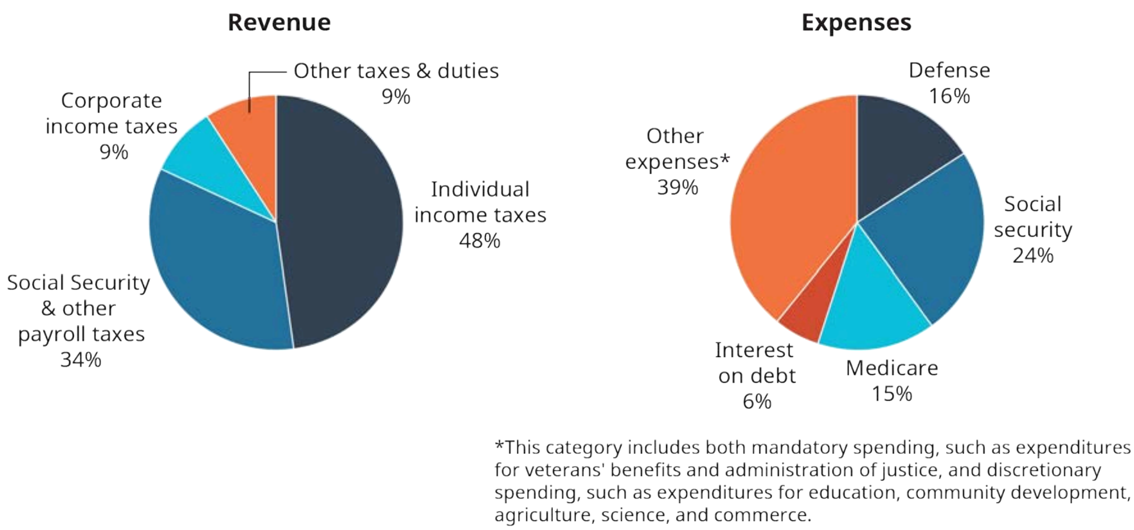

Exhibit 1.9 Revenues and Expenses for the Federal Budget Source: U.S. Treasury, "Final Monthly Treasury Statement of Receipts and Outlays of the United States Government for Fiscal Year 2016," https://www.fiscal.treasury.gov, accessed May 23, 2017.

Whereas fiscal policy has a major impact on business and consumers, continual increases in government spending raises another important issue. When government takes more money from business and consumers (the private sector), a phenomenon known as **crowding out** occurs. Here are three examples of crowding out:

1. The government spends more on public libraries, and individuals buy fewer books at bookstores.
2. The government spends more on public education, and individuals spend less on private education.
3. The government spends more on public transportation, and individuals spend less on private transportation.

In other words, government spending is crowding out private spending.

If the government spends more for programs (social services, education, defense) than it collects in taxes, the result is a **federal budget deficit**. To balance the budget, the government can cut its spending, increase taxes, or do some combination of the two. When it cannot balance the budget, the government must make up any shortfalls by borrowing (just like any business or household).

In 1998, for the first time in a generation, there was a federal budget surplus (revenue exceeding spending) of about $71 billion. That budget surplus was short lived, however. By 2005, the deficit was more than $318 billion. In the fiscal year of 2009, the federal deficit was at an all-time high of more than $1.413 trillion. Six years later, at the end of the 2015 fiscal year, the deficit decreased to $438 billion.[25] The U.S. government has run budget deficits for many years. The accumulated total of these past deficits is the **national debt**, which now amounts to about $19.8 trillion, or about $61,072 for every man, woman, and child in the United States. Total interest on the debt is more than $2.5 trillion a year.[26] To cover the deficit, the U.S. government borrows money from people and businesses in the form of Treasury bills, Treasury notes, and Treasury bonds. These are federal IOUs that pay interest to their owners.

The national debt is an emotional issue debated not only in the halls of Congress, but by the public as well. Some believe that deficits contribute to economic growth, high employment, and price stability. Others have the following reservations about such a high national debt:

- *Not Everyone Holds the Debt:* The government is very conscious of who actually bears the burden of the national debt and keeps track of who holds what bonds. If only the rich were bondholders, then they alone would receive the interest payments and could end up receiving more in interest than they paid in taxes. In the meantime, poorer people, who held no bonds, would end up paying taxes that would be transferred to the rich as interest, making the debt an unfair burden to them. At times, therefore, the government has instructed commercial banks to reduce their total debt by divesting some of their bond holdings. That's also why the Treasury created **savings bonds**. Because these bonds are issued in relatively small denominations, they allow more people to buy and hold government debt.

- *It Crowds Out Private Investment:* The national debt also affects private investment. If the government raises the interest rate on bonds to be able to sell them, it forces private businesses, whose corporate bonds (long-term debt obligations issued by a company) compete with government bonds for investor dollars, to raise rates on their bonds to stay competitive. In other words, selling government debt to finance government spending makes it more costly for private industry to finance its own investment. As a result, government debt may end up crowding out private investment and slowing economic growth in the private sector.

CONCEPT CHECK

1. What are the two kinds of monetary policy?
2. What fiscal policy tools can the government use to achieve its macroeconomic goals?
3. What problems can a large national debt present?

1.6 Microeconomics: Zeroing in on Businesses and Consumers

6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?

Now let's shift our focus from the whole economy to *microeconomics,* the study of households, businesses, and industries. This field of economics is concerned with how prices and quantities of goods and services behave in a free market. It stands to reason that people, firms, and governments try to get the most from their limited resources. Consumers want to buy the best quality at the lowest price. Businesses want to keep costs down and revenues high to earn larger profits. Governments also want to use their revenues to provide the most effective public goods and services possible. These groups choose among alternatives by focusing on the prices of goods and services.

As consumers in a free market, we influence what is produced. If Mexican food is popular, the high demand attracts entrepreneurs who open more Mexican restaurants. They want to compete for our dollars by supplying Mexican food at a lower price, of better quality, or with different features, such as Santa Fe Mexican food rather than Tex-Mex. This section explains how business and consumer choices influence the price and availability of goods and services.

Exhibit 1.10 Galaxy Note 7 Samsung's strategy to take on Apple's iPhone domination hit a terrible snag in 2016, when its Galaxy Note 7 mobile phone was recalled and the product eliminated. Defective batteries in the Note 7 made them catch fire and cause serious damage. Samsung eventually killed the entire line of Note 7 phones, recalling nearly 3 million phones, which cost the company more than $5 billion. *How do businesses determine the optimum quantity of products or services to make available to consumers?* (Credit: Paul Sullivan/ flickr/ Attribution-NoDerivs 2.0 Generic (CC BY-ND 2.0))

The Nature of Demand

Demand is the quantity of a good or service that people are willing to buy at various prices. The higher the price, the lower the quantity demanded, and vice versa. A graph of this relationship is called a **demand curve**.

Let's assume you own a store that sells jackets for snowboarders. From past experience, you know how many jackets you can sell at different prices. The demand curve in **Exhibit 1.11** depicts this information. The *x*-axis (horizontal axis) shows the quantity of jackets, and the *y*-axis (vertical axis) shows the related price of those jackets. For example, at a price of $100, customers will buy (demand) 600 snowboard jackets.

In the graph, the demand curve slopes downward and to the right because as the price falls, people will want to buy more jackets. Some people who were not going to buy a jacket will purchase one at the lower price. Also, some snowboarders who already have a jacket will buy a second one. The graph also shows that if you put a large number of jackets on the market, you will have to reduce the price to sell all of them.

Understanding demand is critical to businesses. Demand tells you *how much you can sell* and *at what price*—in other words, how much money the firm will take in that can be used to cover costs and hopefully earn a profit. Gauging demand is difficult even for the very largest corporations, but particularly for small firms.

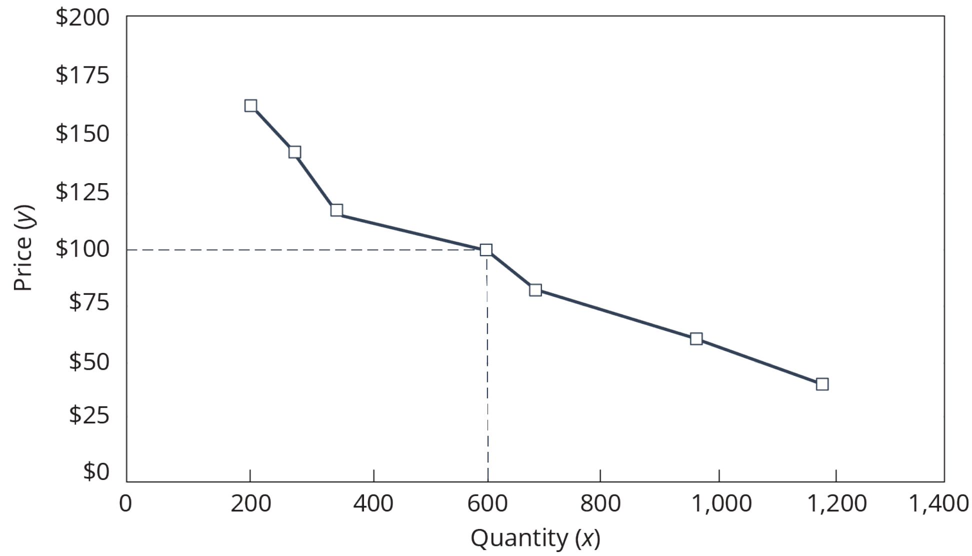

Exhibit 1.11 **Demand Curve for Jackets for Snowboarders**

The Nature of Supply

Demand alone is not enough to explain how the market sets prices. We must also look at **supply**, the quantity of a good or service that businesses will make available at various prices. The higher the price, the greater the number of jackets a supplier will supply, and vice versa. A graph of the relationship between various prices and the quantities a business will supply is a **supply curve**.

We can again plot the quantity of jackets on the *x*-axis and the price on the *y*-axis. As **Exhibit 1.12** shows, 800 jackets will be available at a price of $100. Note that the supply curve slopes upward and to the right, the opposite of the demand curve. If snowboarders are willing to pay higher prices, suppliers of jackets will buy more inputs (for example, Gore-Tex® fabric, dye, machinery, labor) and produce more jackets. The quantity supplied will be higher at higher prices, because manufacturers can earn higher profits.

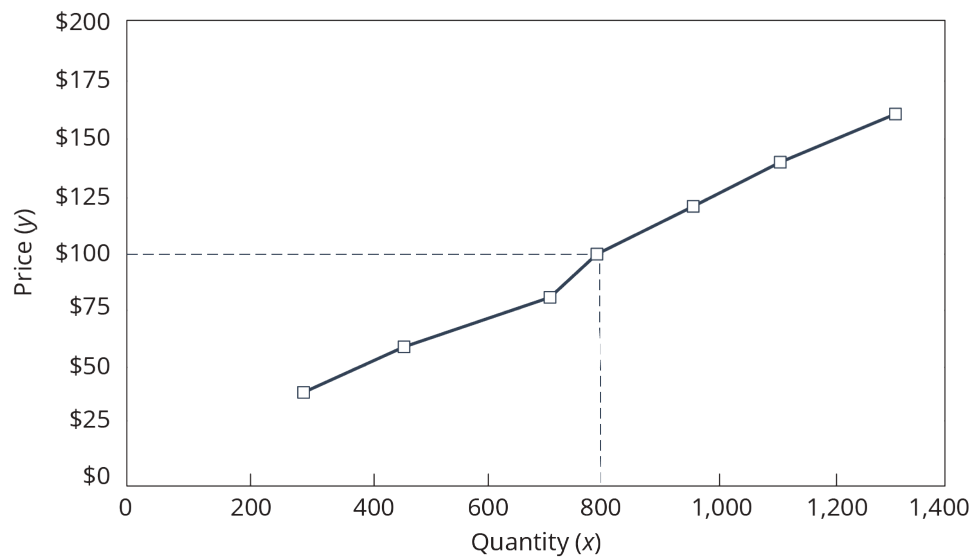

Exhibit 1.12 **Supply Curve for Jackets for Snowboarders**

How Demand and Supply Interact to Determine Prices

In a stable economy, the number of jackets that snowboarders demand depends on the jackets' price. Likewise, the number of jackets that suppliers provide depends on price. But at what price will consumer demand for jackets match the quantity suppliers will produce?

To answer this question, we need to look at what happens when demand and supply interact. By plotting both the demand curve and the supply curve on the same graph in **Exhibit 1.13**, we see that they cross at a certain quantity and price. At that point, labeled E, the quantity demanded equals the quantity supplied. This is the point of **equilibrium**. The equilibrium price is $80; the equilibrium quantity is 700 jackets. At that point, there is a balance between the quantity consumers will buy and the quantity suppliers will make available.

Market equilibrium is achieved through a series of quantity and price adjustments that occur automatically. If the price increases to $160, suppliers produce more jackets than consumers are willing to buy, and a surplus results. To sell more jackets, prices will have to fall. Thus, a surplus pushes prices downward until equilibrium is reached. When the price falls to $60, the quantity of jackets demanded rises above the available supply. The resulting shortage forces prices upward until equilibrium is reached at $80.

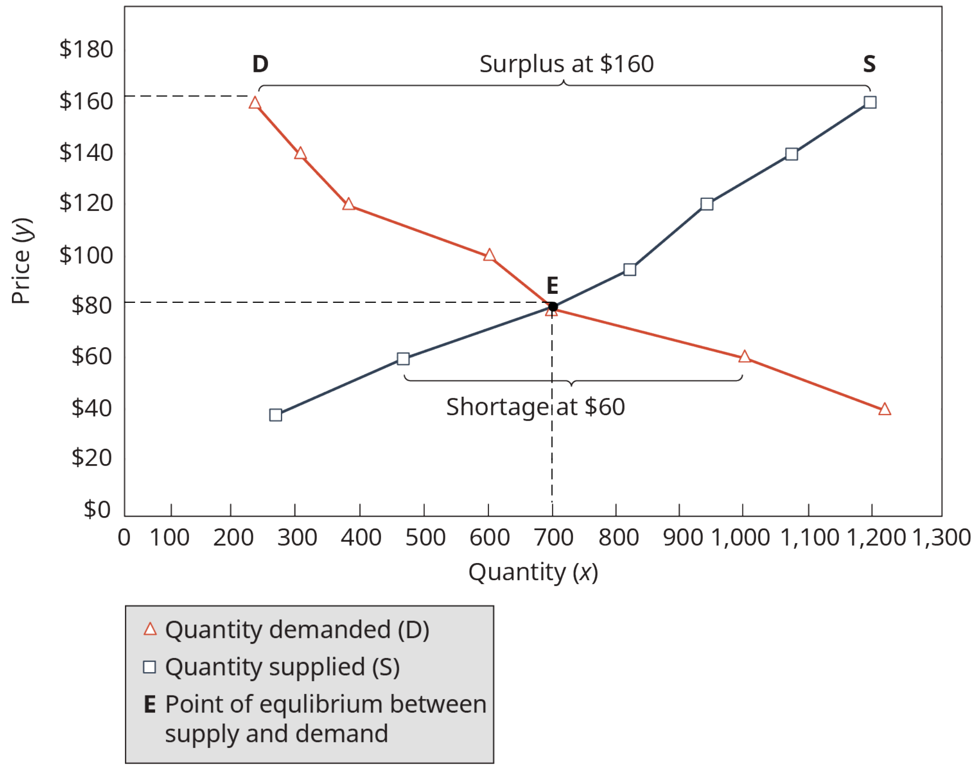

Exhibit 1.13 Equilibrium Price and Quantity for Jackets for Snowboarders

The number of snowboard jackets supplied and bought at $80 will tend to rest at equilibrium unless there is a shift in either demand or supply. If demand increases, more jackets will be purchased at every price, and the demand curve shifts to the right (as illustrated by line D_2 in **Exhibit 1.14**). If demand decreases, less will be bought at every price, and the demand curve shifts to the left (D_1). When demand decreased, snowboarders bought 500 jackets at $80 instead of 700 jackets. When demand increased, they purchased 800.

Changes in Demand

A number of things can increase or decrease demand. For example, if snowboarders' incomes go up, they may decide to buy a second jacket. If incomes fall, a snowboarder who was planning to purchase a jacket may wear an old one instead. Changes in fashion or tastes can also influence demand. If snowboarding were suddenly to go out of fashion, demand for jackets would decrease quickly. A change in the price of related products can also influence demand. For example, if the average price of a snowboard rises to $1,000, people will quit snowboarding, and jacket demand will fall.

Another factor that can shift demand is expectations about future prices. If you expect jacket prices to increase significantly in the future, you may decide to go ahead and get one today. If you think prices will fall, you will postpone your purchase. Finally, changes in the number of buyers will affect demand. Snowboarding is a young person's sport, and the number of teenagers will increase in the next few years. Therefore, the demand for snowboard jackets should increase.

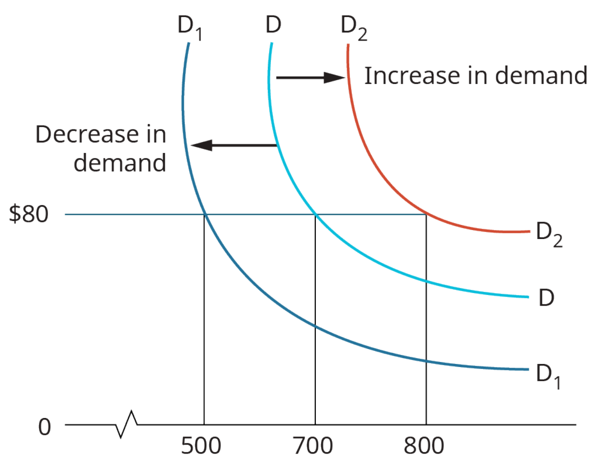

Exhibit 1.14 Shifts in Demand for Jackets for Snowboarders (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

Changes in Supply

Other factors influence the supply side of the picture. New technology typically lowers the cost of production. For example, North Face, a supplier of ski and snowboard jackets, purchased laser-guided pattern-cutting equipment and computer-aided pattern-making equipment. Each jacket was cheaper to produce, resulting in a higher profit per jacket. This provided an incentive to supply more jackets at every price. If the price of resources such as labor or fabric goes up, North Face will earn a smaller profit on each jacket, and the amount supplied will decrease at every price. The reverse is also true. Changes in the prices of other goods can also affect supply.

Let's say that snow skiing becomes a really hot sport again. The number of skiers jumps dramatically, and the price of ski jackets soars. North Face can use its machines and fabrics to produce either ski or snowboard jackets. If the company can make more profit from ski jackets, it will produce fewer snowboard jackets at every price. Also, a change in the number of producers will shift the supply curve. If the number of jacket suppliers increases, they will place more jackets on the market at every price. If any suppliers stop making jackets available, the supply will naturally decrease. Taxes can also affect supply. If the government decides, for some reason, to tax the supplier for every snowboard jacket produced, then profits will fall, and fewer jackets will be offered at every price. **Table 1.2** summarizes the factors that can shift demand and supply curves.

To better understand the relationship between supply and demand across the economy, consider the impact of 2005's Hurricane Katrina on U.S. energy prices. Oil and gas prices were already at high levels before Hurricane Katrina disrupted production in the Gulf Coast. Most U.S. offshore drilling sites are located in the Gulf of Mexico, and almost 30 percent of U.S. refining capacity is in Gulf States that were hit hard by the storm. Prices rose almost immediately as supplies fell while demand remained at the same levels.

The storm drove home the vulnerability of the U.S. energy supply to not only natural disasters, but also terrorist attacks and price increases from foreign oil producers. Many energy policy experts questioned the wisdom of having such a high concentration of oil facilities—about 25 percent of the oil and natural gas infrastructure—in hurricane-prone states. Refiners were already almost at capacity before Katrina's devastation.[27]

Factors That Cause Demand and Supply Curves to Shift		
	Shift Demand	
Factor	**To the Right If**	**To the Left If**
Buyers' incomes	Increase	Decrease
Buyers' preferences/tastes	Increase	Decrease
Prices of substitute products	Increase	Decrease
Expectations about future prices	Will rise	Will fall
Number of buyers	Increases	Decreases
	Shift Supply	
	To the Right If	**To the Left If**
Technology	Lowers cost	Increases cost
Resource prices	Fall	Rise
Changes in prices of other products that can be produced with the same resources	Profit of other product falls	Profit of other product rises
Number of suppliers	Increases	Decreases
Taxes	Decreases	Increases

Table 1.2

High energy prices affect the economy in many ways. With oil at the time costing $50 to $60 a barrel—more than double the 2003 price—both businesses and consumers across the United States felt the pinch in their wallets. Midwestern agricultural businesses export about 70 percent of their grain production through Gulf of Mexico port facilities. With fewer usable docking spaces, barges couldn't unload and return for more crops. The supply of both transportation services and grain products was inadequate to meet demand, pushing up transportation and grain costs. Higher gas prices also contributed to rising prices, as 80 percent of shipping costs are related to fuel.

More than a decade after Katrina, U.S. gas prices have fluctuated dramatically, with the cost of a gallon of regular gas peaking in 2014 at $3.71, dropping as low as $1.69 in early 2015, and moderating to $2.36 in mid-2017. Recent research by JP Morgan Chase revealed that consumers spend roughly 80 percent of their savings from lower gas prices, which helps the overall economy.[28]

CONCEPT CHECK

1. What is the relationship between prices and demand for a product?
2. How is market equilibrium achieved? Describe the circumstances under which the price for gasoline would have returned to equilibrium in the United States after Hurricane Katrina.
3. Draw a graph that shows an equilibrium point for supply and demand.

1.7 Competing in a Free Market

7. What are the four types of market structure?

One of the characteristics of a free-market system is that suppliers have the right to compete with one another. The number of suppliers in a market defines the **market structure**. Economists identify four types of market structures: (1) perfect competition, (2) pure monopoly, (3) monopolistic competition, and (4) oligopoly. **Table 1.3** summarizes the characteristics of each of these market structures.

Perfect Competition

Characteristics of **perfect (pure) competition** include:

- A large number of small firms are in the market.
- The firms sell similar products; that is, each firm's product is very much like the products sold by other firms in the market.
- Buyers and sellers in the market have good information about prices, sources of supply, and so on.
- It is easy to open a new business or close an existing one.

Comparison of Market Structures

Characteristics	Perfect Competition	Pure Monopoly	Monopolistic Competition	Oligopoly
Number of firms in market	Many	One	Many, but fewer than perfect competition	Few

Table 1.3

Comparison of Market Structures				
Characteristics	Perfect Competition	Pure Monopoly	Monopolistic Competition	Oligopoly
Firm's ability to control price	None	High	Some	Some
Barriers to entry	None	Subject to government regulation	Few	Many
Product differentiation	Very little	No products that compete directly	Emphasis on showing perceived differences in products	Some differences
Examples	Farm products such as wheat and corn	Utilities such as gas, water, cable television	Retail specialty clothing stores	Steel, automobiles, airlines, aircraft manufacturers

Table 1.3

In a perfectly competitive market, firms sell their products at prices determined solely by forces beyond their control. Because the products are very similar and each firm contributes only a small amount to the total quantity supplied by the industry, price is determined by supply and demand. A firm that raised its price even a little above the going rate would lose customers. In the wheat market, for example, the product is essentially the same from one wheat producer to the next. Thus, none of the producers has control over the price of wheat.

Perfect competition is an ideal. No industry shows all its characteristics, but the stock market and some agricultural markets, such as those for wheat and corn, come closest. Farmers, for example, can sell all of their crops through national commodity exchanges at the current market price.

Pure Monopoly

At the other end of the spectrum is **pure monopoly**, the market structure in which a single firm accounts for all industry sales of a particular good or service. The firm *is* the industry. This market structure is characterized by **barriers to entry**—factors that prevent new firms from competing equally with the existing firm. Often the barriers are technological or legal conditions. Polaroid, for example, held major patents on instant photography for years. When Kodak tried to market its own instant camera, Polaroid sued, claiming patent violations. Polaroid collected millions of dollars from Kodak. Another barrier may be one firm's control of a natural resource. DeBeers Consolidated Mines Ltd., for example, controls most of the world's supply of uncut diamonds.

Public utilities, such as gas and water companies, are pure monopolies. Some monopolies are created by a government order that outlaws competition. The U.S. Postal Service is currently one such monopoly.

Monopolistic Competition

Three characteristics define the market structure known as **monopolistic competition**:

- Many firms are in the market.
- The firms offer products that are close substitutes but still differ from one another.
- It is relatively easy to enter the market.

Under monopolistic competition, firms take advantage of product differentiation. Industries where monopolistic competition occurs include clothing, food, and similar consumer products. Firms under monopolistic competition have more control over pricing than do firms under perfect competition because consumers do not view the products as perfect substitutes. Nevertheless, firms must demonstrate product differences to justify their prices to customers. Consequently, companies use advertising to distinguish their products from others. Such distinctions may be significant or superficial. For example, Nike says “Just Do It,” and Tylenol is advertised as being easier on the stomach than aspirin.

Oligopoly

An **oligopoly** has two characteristics:

- A few firms produce most or all of the output.
- Large capital requirements or other factors limit the number of firms.

Boeing and Airbus Industries (aircraft manufacturers) and Apple and Google (operating systems for smartphones) are major players in different oligopolistic industries.

With so few firms in an oligopoly, what one firm does has an impact on the other firms. Thus, the firms in an oligopoly watch one another closely for new technologies, product changes and innovations, promotional campaigns, pricing, production, and other developments. Sometimes they go so far as to coordinate their pricing and output decisions, which is illegal. Many antitrust cases—legal challenges arising out of laws designed to control anticompetitive behavior—occur in oligopolies.

The market structure of an industry can change over time. Take, for example, telecommunications. At one time, AT&T had a monopoly on long-distance telephone service nationwide. Then the U.S. government divided the company into seven regional phone companies in 1984, opening the door to greater competition. Other companies such as MCI and Sprint entered the fray and built state-of-the-art fiber-optic networks to win customers from the traditional providers of phone service. The 1996 Telecommunications Act changed the competitive environment yet again by allowing local phone companies to offer long-distance service in exchange for letting competition into their local markets. Today, the broadcasting, computer, telephone, and video industries are converging as companies consolidate through merger and acquisition.

CONCEPT CHECK

1. What is meant by market structure?
2. Compare and contrast perfect competition and pure monopoly. Why is it rare to find perfect competition?
3. How does an oligopoly differ from monopolistic competition?

1.8 Trends in the Business Environment and Competition

8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

Trends in the business and economic environment occur in many areas. As noted earlier, today's workforce is more diverse than ever, with increasing numbers of minorities and older workers. Competition has intensified. Technology has accelerated the pace of work and the ease with which we communicate. Let's look at how companies are meeting the challenges of a changing workforce, the growing demand for energy, and how companies are meeting competitive challenges.

Changing Workforce Demographics

As the baby boomer generation ages, so does the U.S. workforce. In 2010, more than 25 percent of all employees were retirement age. Fast forward to the U.S. labor force in 2017, however, and millennials have taken over the top spot in the labor market, with more than 40 percent of the total workforce. Although older workers are now retiring closer to the traditional retirement age of 65, many plan to keep working beyond 65, often into their 70s. No longer is retirement an all-or-nothing proposition, and older workers in the baby boomer generation are taking a more positive attitude toward their later years. A surprising number of Americans expect to work full- or part-time after "retirement," and most would probably work longer if phased retirement programs were available at their companies. Financial reasons motivate most of these older workers, who worry that their longer life expectancies will mean outliving the money they saved for retirement, especially after retirement savings took a hit during the global recession of 2007–2009. For others, however, the satisfaction of working and feeling productive is more important than money alone.[29]

These converging dynamics continue to create several major challenges for companies today. And by 2020, additional generational shifts are projected to occur in the U.S. labor force, which will have an even bigger effect on how companies do business and retain their employees. Today's workforce spans five generations: recent college graduates (Generation Z); people in their 30s and 40s (millennials and Generation X); baby boomers; and traditionalists (people in their 70s). It is not unusual to find a worker who is 50, 60, or even 70 working for a manager who is not yet 30. People in their 50s and 60s offer their vast experience of "what's worked in the past," whereas those in their 20s and 30s tend to be experimental, open to options, and unafraid to take risks. The most effective managers will be the ones who recognize generational differences and use them to the company's advantage.[30]

Many companies have developed programs such as flexible hours and telecommuting to retain older workers and benefit from their practical knowledge and problem-solving skills. In addition, companies should continually track where employees are in their career life cycles, know when they are approaching retirement age or thinking about retirement, and determine how to replace them and their knowledge and job experiences.[31]

Another factor in the changing workforce is the importance of recognizing diversity among workers of all ages and fostering an inclusive organizational culture. According to a recent report by the U.S. Census Bureau, millennials are the largest generation in U.S. history, and more than 44 percent classify themselves as something other than “white.” In addition, women continue to make progress on being promoted to management, although their path to CEO seems to be filled with obstacles. Recent statistics suggest that fewer than 5 percent of Fortune 500 companies have female CEOs. The most successful organizations will be the ones that recognize the importance of diversity and inclusion as part of their ongoing corporate strategies.[32]

MANAGING CHANGE

EY Makes Diversity and Inclusion a Top Priority

As older workers continue to leave the U.S. labor force and younger individuals begin work or move to other jobs to further their careers, businesses must recognize the importance of diversity and inclusion as key corporate strategies. This is particularly critical as multicultural millennials become the dominant group in the U.S. workforce. One leader in embracing diversity as an important part of corporate life is EY (formerly Ernst & Young), a global leader in assurance, tax, and advisory services.

EY believes its core values and business strategies are firmly based on diversity and inclusiveness, as evidenced by the company landing in the top spot of DiversityInc’s 2017 list of the top companies for diversity. This recognition for EY is no accident; the company has made diversity and inclusion key goals for its more than 214,000 employees around the world. With a diverse workforce becoming the norm, it is no longer acceptable for companies to simply hold a random seminar or two for their managers and employees to discuss diversity and inclusion in the workplace.

Karyn Twaronite, EY’s global diversity and inclusion officer, believes that a simple, ongoing approach is the most effective way to address diversity and inclusion in the workplace. The company uses a decision-making strategy called PTR, or preference, tradition, and requirement, to help managers think about diversity and inclusion. The strategy challenges managers to examine preferences toward job candidates who are similar to themselves, asks them whether their decision about hiring a specific candidate is influenced by traditional characteristics of a certain role, and urges them to make their selection based on the requirements of the job rather than on their personal preferences. In other words, the decision-making tool gives people a way to question the status quo without accusing colleagues of being biased.

Another way EY fosters inclusiveness is sponsoring professional network groups within the organization. These groups provide members with opportunities to network across various EY divisions, create informal mentoring relationships, and strengthen leadership skills. Some of the established networks within EY include groups for LGBT employees; blacks, Latinos, and pan-Asians; women; veterans; and employees with disabilities.

As a global company that works with clients in many countries, EY knows the importance of acknowledging different perspectives and cultures as part of its daily business. The company is committed to making sure employees as well as clients respect different viewpoints and individual differences, including background, education, gender, ethnicity, religious background, sexual orientation, ability, and technical skills. According to EY’s diversity web page, research shows that a company’s diverse teams are more likely to improve market share and have success in new markets and that they demonstrate stronger collaboration and better retention.

Questions for Discussion

1. How does EY’s approach to diversity and inclusion translate to additional revenues for the company?
2. Would a company’s commitment to diversity make a difference to you when interviewing for a job? Why or why not?

Sources: Company website, “A Diverse and Inclusive Workforce,” http://www.ey.com, accessed May 29, 2017; “DiversityInc Top 50: #1—EY: Why They’re on the List,” http://www.diversityinc.com, accessed May 29, 2017; “Founded on Inclusiveness; Strengthened by Diversity: A Place for Everyone,” http://exceptionaley.com, accessed May 29, 2017; Grace Donnelly, “Here’s EY’s Simple But Effective Strategy for Increasing Diversity,” *Fortune,* http://fortune.com, February 10, 2017.

Global Energy Demands

As standards of living improve worldwide, the demand for energy continues to rise. Emerging economies such as China and India need energy to grow. Their demands are placing pressure on the world’s supplies and affecting prices, as the laws of supply and demand would predict. For example, in recent years, China and India were responsible for more than half of the growth in oil products consumption worldwide. State-supported energy companies in China, India, Russia, Saudi Arabia, and other countries will place additional competitive pressure on privately owned oil companies such as BP, Chevron, ExxonMobil, and Shell.[33]

Countries worldwide worry about relying too heavily on one source of supply for energy. The United States imports a large percentage of its oil from Canada and Saudi Arabia. Europeans get 39 percent of their natural gas from Russia’s state-controlled gas utility OAO Gazprom.[34] This gives foreign governments the power to use energy as a political tool. For example, continuing tensions between Russia and Ukraine in November 2015 caused Russia to stop sending natural gas to Ukraine, which also causes gas disruptions in Europe because Russia uses Ukraine’s pipelines to transport some of its gas deliveries to European countries. In 2017, Russia announced plans to build its own pipeline alongside Ukraine’s gas line in the Baltic Sea, which would allow Russia to bypass Ukraine’s pipelines altogether and deliver gas directly to European countries.[35]

Countries and companies worldwide are seeking additional sources of supply to prevent being held captive to one supplier. For example, the relatively new technology of extracting oil from shale rock formations in the United States (known as fracking) has help create an important resource for the country’s oil industry. This innovative approach to finding new sources of energy now accounts for more than half of the country’s oil output, which can help reduce U.S. dependence on foreign oil and create new jobs.[36]

Meeting Competitive Challenges

Companies are turning to many different strategies to remain competitive in the global marketplace. One of the most important is **relationship management**, which involves building, maintaining, and enhancing interactions with customers and other parties to develop long-term satisfaction through mutually beneficial partnerships. Relationship management includes both *supply chain management*, which builds strong bonds with suppliers, and *relationship marketing*, which focuses on customers. In general, the longer a customer stays with a company, the more that customer is worth. Long-term customers buy more, take less of a company’s time, are less sensitive to price, and bring in new customers. Best of all, they require no acquisition or start-up costs. Good long-standing customers are worth so much that in some industries, reducing customer defections by as little as five points—from, say, 15 percent to 10 percent per year—can double profits.

Another important way companies stay competitive is through **strategic alliances** (also called *strategic partnerships*). The trend toward forming these cooperative agreements between business firms is accelerating rapidly, particularly among high-tech firms. These companies have realized that strategic partnerships are more than just important—they are critical. Strategic alliances can take many forms. Some companies enter into strategic alliances with their suppliers, who take over much of their actual production and manufacturing. For example, Nike, the largest producer of athletic footwear in the world, does not manufacture a single shoe.

Other companies with complementary strengths team up. For example, Harry’s Shave Club, an online men’s grooming subscription service, recently teamed up with retail giant Target to improve sales and boost its brand presence among Target shoppers. Harry’s products are now available in Target’s brick-and-mortar stores and on Target’s website as part of an exclusive deal that makes Target the only mass retailer to carry Harry’s grooming products. The men’s shaving industry accounts for more than $2.6 billion in annual sales.[37]

CONCEPT CHECK

1. What steps can companies take to benefit from the aging of their workers and to effectively manage a multigenerational workforce?
2. Why is the increasing demand for energy worldwide a cause for concern?
3. Describe several strategies that companies can use to remain competitive in the global economy.

Key Terms

barriers to entry Factors, such as technological or legal conditions, that prevent new firms from competing equally with an existing firm.

business An organization that strives for a profit by providing goods and services desired by its customers.

business cycles Upward and downward changes in the level of economic activity.

capital The inputs, such as tools, machinery, equipment, and buildings, used to produce goods and services and get them to the customer.

capitalism An economic system based on competition in the marketplace and private ownership of the factors of production (resources); also known as the *private enterprise system.*

circular flow The movement of inputs and outputs among households, businesses, and governments; a way of showing how the sectors of the economy interact.

communism An economic system characterized by government ownership of virtually all resources, government control of all markets, and economic decision-making by central government planning.

consumer price index (CPI) An index of the prices of a “market basket” of goods and services purchased by typical urban consumers.

contractionary policy The use of monetary policy by the Fed to tighten the money supply by selling government securities or raising interest rates.

cost-push inflation Inflation that occurs when increases in production costs push up the prices of final goods and services.

costs Expenses incurred from creating and selling goods and services.

crowding out The situation that occurs when government spending replaces spending by the private sector.

cyclical unemployment Unemployment that occurs when a downturn in the business cycle reduces the demand for labor throughout the economy.

demand The quantity of a good or service that people are willing to buy at various prices.

demand curve A graph showing the quantity of a good or service that people are willing to buy at various prices.

demand-pull inflation Inflation that occurs when the demand for goods and services is greater than the supply.

demography The study of people’s vital statistics, such as their age, gender, race and ethnicity, and location.

economic growth An increase in a nation’s output of goods and services.

economic system The combination of policies, laws, and choices made by a nation’s government to establish the systems that determine what goods and services are produced and how they are allocated.

economics The study of how a society uses scarce resources to produce and distribute goods and services.

entrepreneurs People who combine the inputs of natural resources, labor, and capital to produce goods or services with the intention of making a profit or accomplishing a not-for-profit goal.

equilibrium The point at which quantity demanded equals quantity supplied.

expansionary policy The use of monetary policy by the Fed to increase, or loosen, the growth of the money supply.

factors of production The resources used to create goods and services.

federal budget deficit The condition that occurs when the federal government spends more for programs than it collects in taxes.

Federal Reserve System (the Fed) The central banking system of the United States.

fiscal policy The government’s use of taxation and spending to affect the economy.

frictional unemployment Short-term unemployment that is not related to the business cycle.

full employment The condition when all people who want to work and can work have jobs.
goods Tangible items manufactured by businesses.
gross domestic product (GDP) The total market value of all final goods and services produced within a nation's borders each year.
inflation The situation in which the average of all prices of goods and services is rising.
knowledge The combined talents and skills of the workforce.
knowledge workers Workers who create, distribute, and apply knowledge.
macroeconomics The subarea of economics that focuses on the economy as a whole by looking at aggregate data for large groups of people, companies, or products.
market structure The number of suppliers in a market.
microeconomics The subarea of economics that focuses on individual parts of the economy, such as households or firms.
mixed economies Economies that combine several economic systems; for example, an economy where the government owns certain industries but others are owned by the private sector.
monetary policy A government's programs for controlling the amount of money circulating in the economy and interest rates.
monopolistic competition A market structure in which many firms offer products that are close substitutes and in which entry is relatively easy.
national debt The accumulated total of all of the federal government's annual budget deficits.
not-for-profit organization An organization that exists to achieve some goal other than the usual business goal of profit.
oligopoly A market structure in which a few firms produce most or all of the output and in which large capital requirements or other factors limit the number of firms.
perfect (pure) competition A market structure in which a large number of small firms sell similar products, buyers and sellers have good information, and businesses can be easily opened or closed.
producer price index (PPI) An index of the prices paid by producers and wholesalers for various commodities, such as raw materials, partially finished goods, and finished products.
productivity The amount of goods and services one worker can produce.
profit The money left over after all costs are paid.
purchasing power The value of what money can buy.
pure monopoly A market structure in which a single firm accounts for all industry sales of a particular good or service and in which there are *barriers to entry*.
quality of life The general level of human happiness based on such things as life expectancy, educational standards, health, sanitation, and leisure time.
recession A decline in GDP that lasts for at least two consecutive quarters.
relationship management The practice of building, maintaining, and enhancing interactions with customers and other parties to develop long-term satisfaction through mutually beneficial partnerships.
revenue The money a company receives by providing services or selling goods to customers.
risk The potential to lose time and money or otherwise not be able to accomplish an organization's goals.
savings bonds Government bonds issued in relatively small denominations.
seasonal unemployment Unemployment that occurs during specific seasons in certain industries.
services Intangible offerings of businesses that can't be held, touched, or stored.
socialism An economic system in which the basic industries are owned either by the government itself or by the private sector under strong government control.
standard of living A country's output of goods and services that people can buy with the money they have.
strategic alliance A cooperative agreement between business firms; sometimes called a *strategic partnership.*

structural unemployment Unemployment that is caused by a mismatch between available jobs and the skills of available workers in an industry or region; not related to the business cycle.
supply The quantity of a good or service that businesses will make available at various prices.
supply curve A graph showing the quantity of a good or service that businesses will make available at various prices.
technology The application of science and engineering skills and knowledge to solve production and organizational problems.
unemployment rate The percentage of the total labor force that is not working but is *actively looking for work*.

Summary of Learning Outcomes

1.1 The Nature of Business

1. How do businesses and not-for-profit organizations help create our standard of living?

Businesses attempt to earn a profit by providing goods and services desired by their customers. Not-for-profit organizations, though not striving for a profit, still deliver many needed services for our society. Our standard of living is measured by the output of goods and services. Thus, businesses and not-for-profit organizations help create our standard of living. Our quality of life is not simply the amount of goods and services available for consumers but rather the society’s general level of happiness.

Economists refer to the building blocks of a business as the factors of production. To produce anything, one must have natural resources, labor (human resources), capital, and entrepreneurship to assemble the resources and manage the business. Today’s competitive business environment is based upon knowledge and learning. The companies that succeed will be those that learn fast, use knowledge efficiently, and develop new insights.

1.2 Understanding the Business Environment

2. What are the sectors of the business environment, and how do changes in them influence business decisions?

The external business environment consists of economic, political and legal, demographic, social, competitive, global, and technological sectors. Managers must understand how the environment is changing and the impact of those changes on the business. When economic activity is strong, unemployment rates are low, and income levels rise. The political environment is shaped by the amount of government intervention in business affairs, the types of laws it passes to regulate both domestic and foreign businesses, and the general political stability of a government. Demographics, or the study of people’s vital statistics, are at the heart of many business decisions. Businesses today must deal with the unique preferences of different generations, each of which requires different marketing approaches and different goods and services. The population is becoming increasingly diverse: currently minorities represent more than 38 percent of the total U.S. population, and that number will continue to increase over the next several decades. Minorities’ buying power has increased significantly as well, and companies are developing products and marketing campaigns that target different ethnic groups. Social factors—our attitudes, values, and lifestyles—influence what, how, where, and when people purchase products. They are difficult to predict, define, and measure because they can be very subjective. They also change as people move through different life stages.

1.3 How Business and Economics Work

3. What are the primary features of the world’s economic systems, and how are the three sectors of the U.S. economy linked?

Economics is the study of how individuals, businesses, and governments use scarce resources to produce and distribute goods and services. Today there is a global trend toward capitalism. Capitalism, also known as the *private enterprise system,* is based upon marketplace competition and private ownership of the factors of production. Competition leads to more diverse goods and services, keeps prices stable, and pushes businesses to become more efficient.

In a communist economy, the government owns virtually all resources, and economic decision-making is done by central government planning. Governments have generally moved away from communism because it is inefficient and delivers a low standard of living. Socialism is another centralized economic system in which the basic industries are owned by the government or by the private sector under strong government control. Other industries may be privately owned. The state is also somewhat influential in determining the goals of business, the prices and selection of products, and the rights of workers. Most national economies today are a mix of socialism and capitalism.

The two major areas in economics are macroeconomics, the study of the economy as a whole, and microeconomics, the study of households and firms. The individual, business, and government sectors of the economy are linked by a series of two-way flows. The government provides public goods and services to the other two sectors and receives income in the form of taxes. Changes in one flow affect the other sectors.

1.4 Macroeconomics: The Big Picture

4. How do economic growth, full employment, price stability, and inflation indicate a nation’s economic health?

A nation’s economy is growing when the level of business activity, as measured by gross domestic product (GDP) is rising. GDP is the total value of all goods and services produced in a year. The goal of full employment is to have a job for all who can and want to work. How well a nation is meeting its employment goals is measured by the unemployment rate. There are four types of unemployment: frictional, structural, cyclical, and seasonal. With price stability, the overall prices of goods and services are not moving very much either up or down. Inflation is the general upward movement of prices. When prices rise, purchasing power falls. The rate of inflation is measured by changes in the consumer price index (CPI) and the producer price index (PPI). There are two main causes of inflation. If the demand for goods and services exceeds the supply, prices will rise. This is called demand-pull inflation. With cost-push inflation, higher production costs, such as expenses for materials and wages, increase the final prices of goods and services.

1.5 Achieving Macroeconomic Goals

5. How does the government use monetary policy and fiscal policy to achieve its macroeconomic goals?

Monetary policy refers to actions by the Federal Reserve System (the Fed) to control the money supply. When the Fed restricts the money supply, interest rates rise, the inflation rate drops, and economic growth slows. By expanding the money supply, the Fed stimulates economic growth. The government also uses fiscal policy—changes in levels of taxation and spending—to control the economy. Reducing taxes or increasing spending stimulates the economy; raising taxes or decreasing spending does the opposite. When the government spends more than it receives in tax revenues, it must borrow to finance the deficit. Some economists favor deficit spending as a way to stimulate the economy; others worry about our high level of national debt.

1.6 Microeconomics: Zeroing in on Businesses and Consumers

6. What are the basic microeconomic concepts of demand and supply, and how do they establish prices?

Demand is the quantity of a good or service that people will buy at a given price. Supply is the quantity of a good or service that firms will make available at a given price. When the price increases, the quantity demanded falls, but the quantity supplied rises. A price decrease leads to increased demand but a lower supply. At the point where the quantity demanded equals the quantity supplied, demand and supply are in balance. This equilibrium point is achieved by market adjustments of quantity and price.

1.7 Competing in a Free Market

7. What are the four types of market structure?

Market structure is the number of suppliers in a market. Perfect competition is characterized by a large number of buyers and sellers, very similar products, good market information for both buyers and sellers, and ease of entry into and exit from the market. In a pure monopoly, there is a single seller in a market. In monopolistic competition, many firms sell close substitutes in a market that is fairly easy to enter. In an oligopoly, a few firms produce most or all of the industry’s output. An oligopoly is also difficult to enter, and what one firm does will influence others.

1.8 Trends in the Business Environment and Competition

8. Which trends are reshaping the business, microeconomic, and macroeconomic environments and competitive arena?

To remain competitive, businesses must identify and respond to trends in the various sectors of the business environment. As the population ages, large numbers of baby boomers are approaching retirement age. Companies must plan for this exodus of employees and find ways to retain the vast amounts of knowledge they represent. Many older workers are choosing to continue working after traditional retirement age, creating a five-generation workforce. Worldwide demand for energy, especially from China and India, is challenging oil companies to increase supplies or to find alternative technologies to produce more oil, such as fracking. U.S. vulnerability to disruptions in energy supply became painfully apparent when Hurricane Katrina put Gulf Coast refineries and offshore drilling rigs out of commission. Companies are using relationship management and strategic alliances to compete effectively in the global economy.

Preparing for Tomorrow's Workplace Skills

1. Select a not-for-profit organization whose mission interests you. What are the organization’s objectives? What resources does it need to achieve those goals? Select a for-profit business that provides a similar service, and compare the two organizations. How does each use the factors of production? (Resources, Information, Systems)
2. **Team Activity** Form seven teams. Each team is responsible for one of the sectors of the external business environment discussed in the chapter (economic, political/legal, demographic, social, competitive, global, and technological). Your boss, the company president, has asked each team to report on the changes in that area of the external environment and how they will affect the firm over the next five years. The firm is the Boeing Company. Each team should use the library, the internet, and other data sources to make its projections. Each team member should examine at least one data source. The team should then pool the data and prepare its response. A spokesperson for each team should present the findings to the class. (Interpersonal, Resources, Information)
3. If a friend claimed, “Economics is all theory and not very practical,” how might you counter this claim? Share your rationale with the class. (Interpersonal, Information)
4. **Team Activity** Create two teams of four people each. Have one side choose a communist economy and the other capitalism. Debate the proposition that “capitalism/a command economy is good for developing nations.” (Interpersonal, Information)
5. What are the latest actions the federal government has taken to manage the economy? Has it used

monetary policy or fiscal policy to achieve its macroeconomic goals? Summarize your findings. Choose one of the following industries, and discuss how the government's actions will affect that industry: airlines, automobile manufacturers, banking, biotechnology, chemical manufacturing, home building, oil and gas, retail stores, and telecommunication services. (Information, Systems)

6. As a manufacturer of wireless headphones, you are questioning your pricing policies. You note that over the past five years, the CPI increased an average of 3 percent per year but that the price of a pair of wireless headphones increased an average of 8 percent per year for the first three years and 2 percent per year for the next two years. What does this information tell you about demand, supply, and other factors influencing the market for these headphones? (Resources, Information)

Ethics Activity

Historically, diesel cars have not been big sellers in the U.S. auto market, mainly because their engines couldn't pass the strict emissions standards set up by the Environmental Protection Agency and the California Air Resources Board. But that all changed in 2005, when German automaker Volkswagen made a decided push to develop "clean diesel" engines, specifically manufactured to meet strict U.S. emissions standards.

By 2010, VW had introduced several models of diesel cars in the United States, and their sales helped propel Volkswagen to the number-two slot in global auto sales, after Toyota and ahead of GM. While VW was receiving major media attention for its clean diesel models, researchers from West Virginia University discovered that these so-called clean engines had been constructed with a "defeat device"—software that could actually tell when the car was being tested off road for emissions and lower the level of emissions that harm the environment.

By December 2014, Volkswagen agreed to voluntarily recall more than a half-million clean diesel cars in the United States to address the emissions issues. But the scandal continued to escalate, with accusations that senior management knew about the rigged engines, and VW's CEO resigned and several other executives were fired.

Class-action lawsuits and other litigation followed, and in April 2017, VW agreed to a $4.3 billion settlement, which included a criminal fine of $2.8 billion, as well as various buyback plans for the affected diesel cars. In addition, over the last several years, VW has experienced a significant decline in U.S. sales and is now trying to win back customers.

Using a web search tool, locate information about this topic, and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: How can VW ensure that its diesel cars now comply with U.S. emissions standards? What can VW do to regain consumers' confidence after this worldwide scandal? Do you agree with the billions of dollars in fines that VW will have to pay to move beyond the emissions debacle?

Sources: "VW Diesel Crisis: Timeline of Events," https://www.cars.com, May 19, 2017; Jack Ewing, "Inside VW's Campaign of Trickery," *The New York Times,* http://www.nytimes.com, May 7, 2017; Christoph Rauwald, "How a Top-Secret Deal Could Have Stopped VW's Diesel Scandal," *Bloomberg,* http://www.bloomberg.com, January 12, 2017; "6 VW Execs Indicted as Carmaker Agrees to $4.3 Billion Diesel Cheat Settlement," *Fortune,* http://fortune.com, January 12, 2017; Geoffrey Smith and Roger Parloff, "Hoaxwagen: Inside Volkswagen's Diesel Fraud," *Fortune*, http://fortune.com, March 7, 2016.

Working the Net

1. The Bureau of Labor Statistics compiles demographic data. Visit **http://www.bls.gov/bls/demographics.htm**, and describe the different types of information it provides. What kinds of changes are likely to occur in the United States over the next 25 years? Click on Spending & Time Use and select How Americans Spend Time to read about the American Time Use Survey. What trends can you identify?
2. Go to either the Red Herring **(http://www.redherring.com)** or Wired **(http://www.wired.com)** site and research technology trends. Compile a list of three trends that sound most promising to you, and describe them briefly. How will they affect businesses? What impact, if any, will they have on you personally?
3. Use the Bureau of Labor Statistics site (**http://stat.bls.gov)** to determine the current trends in GDP growth, unemployment, and inflation. What do these trends tell you about the level of business activity and the business cycle? If you owned a staffing agency, how would this information affect your decision-making?
4. What's the latest U.S. economic news? Go to the CNBC website, and select the Economy page, which categorizes news about the world economy, the U.S. economy, and other important topics **(http://www.cnbc.com/economy/)**. Read the various articles about the U.S. economy, and then do the same for GDP Outlook. Prepare a summary of what you learned, and use it to discuss where you think the economy is headed for the next 6 to 12 months.
5. How would you spend the national budget if you were president? Here's your chance to find out how your ideas would affect the federal budget. Go online to Committee for a Responsible Federal Budget, at **http://www.crfb.org**, and under Tools, click on Stabilize the Debt, which is an exercise in making difficult decisions and how government officials make trade-offs when they prepare the federal budget. Experiment with your own budget ideas at the site. What are the effects of your decisions?

Critical Thinking Case

Walmart Gets Serious about E-Commerce

As the world's largest retailer, Walmart has built thousands of brick-and-mortar stores in the United States, Mexico, and elsewhere. Although a success story when it comes to traditional retail locations, Walmart has struggled with its e-commerce efforts, with recent online sales accounting for about 3 percent of the company's $300 billion in annual sales. The company has tried several different e-commerce strategies in the past, but none of them was an overwhelming success. Some company insiders objected to the pricing strategy used for online purchases; they were fearful that Walmart's lower prices online would take customers (and sales) away from the retail locations.

Doug McMillon, Walmart's CEO since 2014, believed a significant change was needed in the company's e-commerce business, and he recently made changes in a big way. Over the past two years, Walmart spent billions to acquire several online companies to expand its e-commerce business in an effort to take a small bite out of retail giant Amazon's success. In 2016, Walmart purchased Jet.com, an e-commerce site that sells a little bit of everything (books, clothing, electronics, etc.) at discount prices. Once the $3 billion acquisition was completed, Jet's cofounder and CEO, Marc Lore, who now runs Walmart's e-commerce platform, worked with McMillon to identify other established online companies to add to their e-commerce portfolio, and add they did.

First Walmart purchased footwear e-tailer ShoeBuy for $70 million in January 2017. The following month, Walmart bought outdoor specialty retailer Moosejaw for $51 million. Then in March, Walmart paid $75 million for ModCloth, an eclectic shopping site for women's fashions. Walmart is also said to be in negotiations to buy Bonobos, a hip fashion retailer geared to millennial males.

Reaction to the acquisitions has been mixed, depending on whom you ask. Retail analysts applaud the company's radical move, pointing out that several well-known traditional retailers have closed their doors or filed bankruptcy because they failed to take part in the e-commerce revolution. Fashionistas, on the other hand, are lukewarm about the move. However, McMillon's decision to allow the online retailers to operate independently may help retain loyal customers. The new e-commerce strategy may also lure typical in-store shoppers to take advantage of the expanded offerings available through both Walmart.com and Jet.com.

Critical Thinking Questions

1. What are some advantages of Walmart purchasing established web businesses?
2. What impact is Walmart's acquisition of nontraditional retailers likely to have on the shopping habits of Walmart's customers?
3. How will the aggressive e-commerce plan implemented by Walmart affect operations at its retail locations?

Sources: Brad Stone and Matthew Boyle, "Amazon Won't Know What Hit 'Em!" *Bloomberg Businessweek,* http://www.bloomberg.com, May 8–May 14, 2017; "What an Acquisition of Bonobos Would Signal About Wal-Mart's Strategy," *Forbes,* http://www.forbes.com, May 9, 2017; "Walmart Acquires Niche Online Retailers, to the Dismay of Hipsters," *Denver Post,* http://www.denverpost.com, March 24, 2017; Alana Abramson, "Walmart Acquires Online Women's Retailer ModCloth," *Fortune,* http://fortune.com, March 17, 2017; Phil Wahba, "Walmart's 29% Online Holiday Season Growth Sends Shares Jumping," *Fortune,* http://fortune.com, February 21, 2017; Laura Heller, "Take That Amazon: Walmart Buys Moosejaw for $51 Million," *Forbes,* http://www.forbes.com, February 15, 2017; "Walmart Acquires ShoeBuy for $70 Million," *Business Insider,* http://www.businessinsider.com, January 6, 2017.

Hot Links Address Book

1. What makes a company good to work for or most admired? Find out by checking *Fortune*'s special lists at **http://www.fortune.com**.
2. Which country has the largest GDP? The most people? The answers can be found in The World Factbook at **https://www.cia.gov**.
3. Get the scoop on the latest technology trends affecting our lives from CNET's website at **http://www.cnet.com**. The site also includes product reviews, how-to videos, and smart home features.
4. The Federal Reserve Board issues a variety of statistical information about the state of the U.S. economy. Find it at the Federal Reserve's site by clicking on the Economic Research and Data links: **http://www.federalreserve.gov**.
5. Want to know the current public debt per citizen, or even what it was in 1790? Go to **https://www.transparency.treasury.gov/** and click on National Debt.
6. The U.S. Bureau of Economic Analysis (BEA) tracks national and regional economic statistics, including the GDP. To find the latest GDP statistics, visit the BEA at.
7. How are the job prospects in your area? Your region's unemployment statistics can give you an idea of how hard it will be to find a job. Find the most recent unemployment statistics from the Bureau of Labor

Statistics at **http://www.bls.gov**.

8. How do the PPI and the CPI differ? Get the answers to this and other questions about the PPI by visiting the Bureau of Labor Statistics PPI site at **http://www.bls.gov/ppi**.

2

Making Ethical Decisions and Managing a Socially Responsible Business

Exhibit 2.1

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. What philosophies and concepts shape personal ethical standards?
2. How can organizations encourage ethical business behavior?
3. What is corporate social responsibility?
4. How do businesses meet their social responsibilities to various stakeholders?
5. What are the trends in ethics and corporate social responsibility?

EXPLORING BUSINESS CAREERS

Playing with a Purpose at Hasbro

Hasbro is a global play and entertainment company that takes corporate social responsibility (CSR) very seriously. Founded nearly a century ago in Rhode Island, Hasbro integrates its CSR efforts throughout the organization with the goal of helping to make the world a better place for children of all ages.

In 2017, the company achieved the number one spot in the “100 Best Corporate Citizens” rankings, published annually by *Corporate Responsibility* magazine. Hasbro is no stranger to this achievement; over the past five years, Hasbro has consistently been in the top five spots on this prestigious list—and that is no accident.

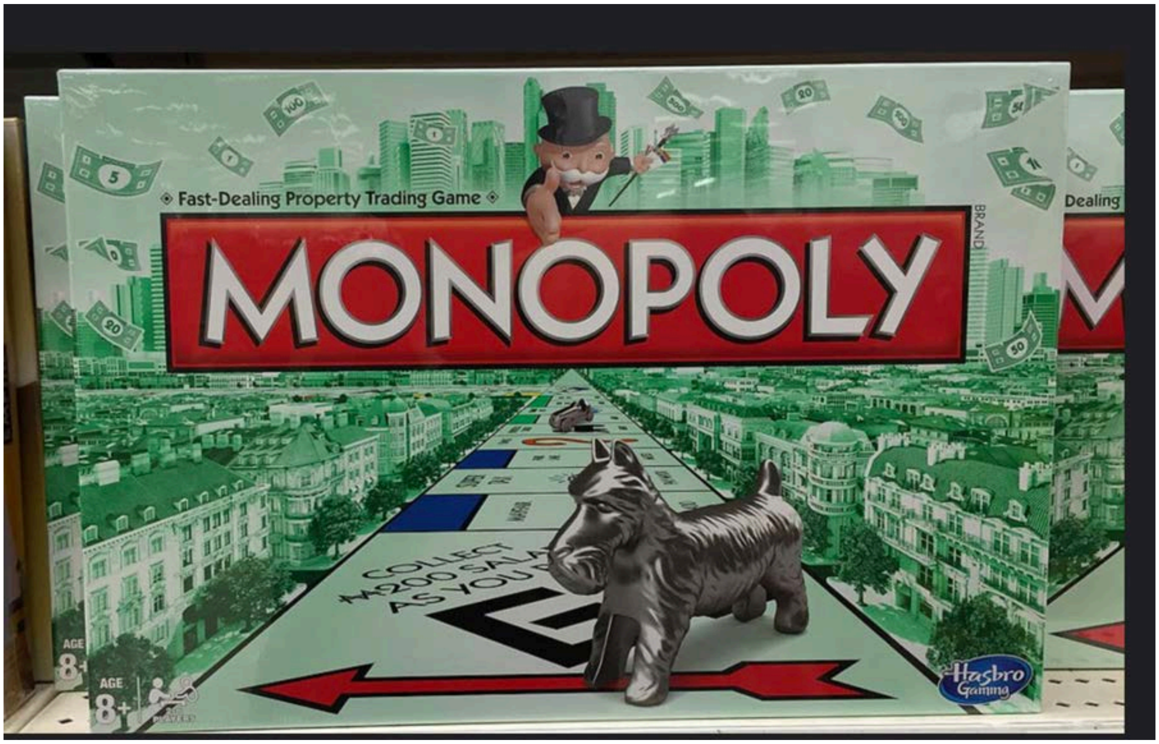

Exhibit 2.2 Hasbro's Monopoly game (Credit: Ben Tsai/ Flickr/ Public Domain)

With more than 5,000 employees, Hasbro relies heavily on its strategic brand blueprint to guide its efforts in CSR, innovation, philanthropy, and product development. With a business portfolio that includes such well-known brands as Nerf, Play-Doh, Transformers, Monopoly, and The Game of Life, the company focuses its CSR efforts on four key areas: product safety, environmental sustainability, human rights and ethical sourcing, and community.

According to the company, product safety is its highest priority. Hasbro uses a five-step quality assurance process that starts with design and then moves to engineering, manufacturing, and packaging. Another key part of product safety at Hasbro is incorporating continuous feedback from both consumers and retailers and insisting that these high standards and quality processes apply to all third-party factories worldwide that manufacture its products.

Hasbro is also committed to finding new ways to reduce its environmental footprint. Over the past several years, the company has reduced energy consumption, cut greenhouse gas emissions, and reduced water consumption and waste production in its production facilities. In addition, Hasbro has totally eliminated the use of wire ties in all of its product packaging, saving more than *34,000* miles of wire ties—more than enough to wrap around the earth's circumference.

Human rights and ethical sourcing remains a key ingredient of Hasbro's CSR success. Treating people fairly is a core company value, as is working diligently to make great strides in diversity and inclusion at all levels of the organization. Company personnel work closely with third-party factories to ensure that the human rights of all workers in the Hasbro global supply chain are recognized and upheld.

Philanthropy, corporate giving, and employee volunteering are key components of the Hasbro community. Through its various charitable programs, Hasbro made close to $15 million in financial contributions and product donations in 2016, which reached close to an estimated 4 million children around the globe. Several years ago the company started an annual Global Day of Joy as a way of engaging its employees worldwide in community service. In a recent year, more than 93 percent of Hasbro's employees participated in service projects in more than 40 countries.

Hasbro is in the business of storytelling, and its CSR efforts tell the story of an ethical, responsible organization whose mission is to create the world's best play experiences. Its ability to be accountable for its actions and to help make the world a better place one experience at time continues to make it a highly successful company.

Sources: Brian Goldner, "Who Are You Really?—Brian Goldner, President & CEO for Hasbro, Inc.," http://insights.ethisphere.com, accessed June 29, 2017; "CSR Fact Sheet," https://csr.hasbro.com, accessed June 23, 2017; "The World's Biggest Public Companies: Hasbro," *Forbes,* https://www.forbes.com, accessed June 23, 2017; "2016 Global Philanthropy & Social Impact," https://csr.hasbro.com, accessed June 23, 2017; Elizabeth Gurdus, "Hasbro CEO Reveals the Magic Behind the Toymaker's Earnings Beat," *CNBC,* http://www.cnbc.com, April 24, 2017; Jade Burke, "Hasbro Reaches Top Spot in CSR Listing," *Toy News,* http://www.toynews-online.biz, April 21, 2017; Kathrin Belliveau, "CSR at Hasbro: What It Means to Play with Purpose," *LinkedIn,* https://www.linkedin.com, April 20, 2017.

Every day, managers and business owners make business decisions based on what they believe to be right and wrong. Through their actions, they demonstrate to their employees what is and is not acceptable behavior and shape the moral standard of the organization. As you will see in this module, personal and professional ethics are important cornerstones of an organization and shape its ultimate contributions to society in the form of corporate social responsibility. First, let's consider how individual business ethics are formed.

2.1 Understanding Business Ethics

1. What philosophies and concepts shape personal ethical standards?

Ethics is a set of moral standards for judging whether something is right or wrong. The first step in understanding business ethics is learning to recognize an **ethical issue**. An ethical issue is a situation where someone must choose between a set of actions that may be ethical or unethical. For example, Martin Shkreli, former CEO of Turing Pharmaceuticals, raised the price of a drug used for newborns and HIV patients by more than *5000* percent, defending the price increase as a "great business decision."[1] Few people would call that ethical behavior. But consider the actions of the stranded, hungry people in New Orleans who lost everything in the aftermath of Hurricane Katrina. They broke into flooded stores, taking food and bottled water without paying for them. Was this unethical behavior? Or what about the small Texas plastics manufacturer that employed over 100 people and specialized in the Latin American market? The president was distraught because he knew the firm would be bankrupt by the end of the year if it didn't receive more contracts. He knew that he was losing business because he refused to pay bribes. Bribes were part of the culture in his major markets. Closing the firm would put many people out of work. Should he start paying bribes in order to stay in business? Would this be unethical? Let's look at the next section to obtain some guidance on recognizing unethical situations.

Recognizing Unethical Business Activities

Researchers from Brigham Young University tell us that all unethical business activities will fall into one of the following categories:

1. *Taking things that don't belong to you.* The unauthorized use of someone else's property or taking property under false pretenses is taking something that does not belong to you. Even the smallest offense, such as using the postage meter at your office for mailing personal letters or exaggerating your travel expenses, belongs in this category of ethical violations.
2. *Saying things you know are not true.* Often, when trying for a promotion and advancement, fellow employees discredit their coworkers. Falsely assigning blame or inaccurately reporting conversations is lying. Although "This is the way the game is played around here" is a common justification, saying things that are untrue is an ethical violation.
3. *Giving or allowing false impressions.* The salesperson who permits a potential customer to believe that cardboard boxes will hold the customer's tomatoes for long-distance shipping when the salesperson knows the boxes are not strong enough has given a false impression. A car dealer who fails to disclose that a car has been in an accident is misleading potential customers.
4. *Buying influence or engaging in a conflict of interest.* A conflict of interest occurs when the official responsibilities of an employee or government official are influenced by the potential for personal gain. Suppose a company awards a construction contract to a firm owned by the father of the state attorney general while the state attorney general's office is investigating that company. If this construction award has the potential to shape the outcome of the investigation, a conflict of interest has occurred.
5. *Hiding or divulging information.* Failing to disclose the results of medical studies that indicate your firm's new drug has significant side effects is the ethical violation of hiding information that the product could be harmful to purchasers. Taking your firm's product development or trade secrets to a new place of employment constitutes the ethical violation of divulging proprietary information.
6. *Taking unfair advantage.* Many current consumer protection laws were passed because so many businesses took unfair advantage of people who were not educated or were unable to discern the nuances of complex contracts. Credit disclosure requirements, truth-in-lending provisions, and new regulations on auto leasing all resulted because businesses misled consumers who could not easily follow the jargon of long, complex agreements.
7. *Committing improper personal behavior.* Although the ethical aspects of an employee's right to privacy are still debated, it has become increasingly clear that personal conduct outside the job can influence performance and company reputation. Thus, a company driver must abstain from substance abuse because of safety issues. Even the traditional company holiday party and summer picnic have come under scrutiny due to the possibility that employees at and following these events might harm others through alcohol-related accidents.
8. *Abusing power and mistreating individuals.* Suppose a manager sexually harasses an employee or subjects employees to humiliating corrections or reprimands in the presence of customers. In some cases, laws protect employees. Many situations, however, are simply interpersonal abuse that constitutes an ethical violation.
9. *Permitting organizational abuse.* Many U.S. firms with operations overseas, such as Apple, Nike, and Levi Strauss, have faced issues of organizational abuse. The unfair treatment of workers in international operations appears in the form of child labor, demeaning wages, and excessive work hours. Although a business cannot change the culture of another country, it can perpetuate—or stop—abuse through its operations there.
10. *Violating rules.* Many organizations use rules and processes to maintain internal controls or respect the authority of managers. Although these rules may seem burdensome to employees trying to serve customers, a violation may be considered an unethical act.

11. *Condoning unethical actions.* What if you witnessed a fellow employee embezzling company funds by forging her signature on a check? Would you report the violation? A winking tolerance of others' unethical behavior is itself unethical.[2]

After recognizing that a situation is unethical, the next question is what do you do? The action that a person takes is partially based upon his or her ethical philosophy. The environment in which we live and work also plays a role in our behavior. This section describes personal philosophies and legal factors that influence the choices we make when confronting an ethical dilemma.

Justice—The Question of Fairness

Another factor influencing individual business ethics is **justice**, or what is fair according to prevailing standards of society. We all expect life to be reasonably fair. You expect your exams to be fair, the grading to be fair, and your wages to be fair, based on the type of work being done.

Today we take justice to mean an equitable distribution of the burdens and rewards that society has to offer. The distributive process varies from society to society. Those in a democratic society believe in the "equal pay for equal work" doctrine, in which individuals are rewarded based on the value the free market places on their services. Because the market places different values on different occupations, the rewards, such as wages, are not necessarily equal. Nevertheless, many regard the rewards as just. A politician who argued that a supermarket clerk should receive the same pay as a physician, for example, would not receive many votes from the American people. At the other extreme, communist theorists have argued that justice would be served by a society in which burdens and rewards were distributed to individuals according to their abilities and their needs, respectively.

Utilitarianism—Seeking the Best for the Majority

One of the philosophies that may influence choices between right and wrong is **utilitarianism**, which focuses on the consequences of an action taken by a person or organization. The notion that people should act so as to generate the greatest good for the greatest number is derived from utilitarianism. When an action affects the majority adversely, it is morally wrong. One problem with this philosophy is that it is nearly impossible to accurately determine how a decision will affect a large number of people.

Another problem is that utilitarianism always involves both winners and losers. If sales are slowing and a manager decides to fire five people rather than putting everyone on a 30-hour workweek, the 20 people who keep their full-time jobs are winners, but the other five are losers.

A final criticism of utilitarianism is that some "costs," although small relative to the potential good, are so negative that some segments of society find them unacceptable. Reportedly, the backs of animals a year are deliberately broken so that scientists can conduct spinal cord research that could someday lead to a cure for spinal cord injuries. To a number of people, however, the "costs" are simply too horrible for this type of research to continue.

Following Our Obligations and Duties

The philosophy that says people should meet their obligations and duties when analyzing an ethical dilemma is called **deontology**. This means that a person will follow his or her obligations to another individual or society because upholding one's duty is what is considered ethically correct. For instance, people who follow this philosophy will always keep their promises to a friend and will follow the law. They will produce very consistent decisions, because they will be based on the individual's set duties. Note that this theory is not necessarily concerned with the welfare of others. Say, for example, a technician for Orkin Pest Control has decided that it's his ethical duty (and is very practical) to always be on time to meetings with homeowners. Today he is running late. How is he supposed to drive? Is the technician supposed to speed, breaking his duty to society to uphold the law, or is he supposed to arrive at the client's home late, breaking his duty to be on time? This scenario of conflicting obligations does not lead us to a clear ethically correct resolution, nor does it protect the welfare of others from the technician's decision.

Individual Rights

In our society, individuals and groups have certain rights that exist under certain conditions regardless of any external circumstances. These rights serve as guides when making individual ethical decisions. The term *human rights* implies that certain rights—to life, to freedom, to the pursuit of happiness—are bestowed at birth and cannot be arbitrarily taken away. Denying the rights of an individual or group is considered to be unethical and illegal in most, though not all, parts of the world. Certain rights are guaranteed by the government and its laws, and these are considered *legal rights.* The U.S. Constitution and its amendments, as well as state and federal statutes, define the rights of American citizens. Those rights can be disregarded only in extreme circumstances, such as during wartime. Legal rights include the freedom of religion, speech, and assembly; protection from improper arrest and searches and seizures; and proper access to counsel, confrontation of witnesses, and cross-examination in criminal prosecutions. Also held to be fundamental is the right to privacy in many matters. Legal rights are to be applied without regard to race, color, creed, gender, or ability.

CONCEPT CHECK

1. How are individual business ethics formed?
2. What is utilitarianism?
3. How can you recognize unethical activities?

2.2 How Organizations Influence Ethical Conduct

2. How can organizations encourage ethical business behavior?

People choose between right and wrong based on their personal code of ethics. They are also influenced by the ethical environment created by their employers. Consider the following headlines:

- Investment advisor Bernard Madoff sentenced to 150 years in prison for swindling clients out of more than $65 billion.
- Former United Airlines CEO Jeff Smisek leaves the company after a federal investigation into whether United tried to influence officials at the Port Authority of New York.
- Renaud Laplanche, the founder of Lending Club, loses his job because of faulty practices and conflicts of interest at the online peer-to-peer lender.
- Wells Fargo CEO John Stumpf fired after company employees opened more than 2 million fake accounts

to meet aggressive sales targets.[3]

As these actual stories illustrate, poor business ethics can create a very negative image for a company, can be expensive for the firm and/or the executives involved, and can result in bankruptcy and jail time for the offenders. Organizations can reduce the potential for these types of liability claims by educating their employees about ethical standards, by leading through example, and through various informal and formal programs.

Leading by Example

Employees often follow the examples set by their managers. That is, leaders and managers establish patterns of behavior that determine what's acceptable and what's not within the organization. While Ben Cohen was president of Ben & Jerry's ice cream, he followed a policy that no one could earn a salary more than seven times that of the lowest-paid worker. He wanted all employees to feel that they were equal. At the time he resigned, company sales were $140 million, and the lowest-paid worker earned $19,000 per year. Ben Cohen's salary was $133,000, based on the "seven times" rule. A typical top executive of a $140 million company might have earned 10 times Cohen's salary. Ben Cohen's actions helped shape the ethical values of Ben & Jerry's.

Offering Ethics Training Programs

In addition to providing a system to resolve ethical dilemmas, organizations also provide formal training to develop an awareness of questionable business activities and practice appropriate responses. Many companies have some type of ethics training program. The ones that are most effective, like those created by Levi Strauss, American Express, and Campbell Soup Company, begin with techniques for solving ethical dilemmas such as those discussed earlier. Next, employees are presented with a series of situations and asked to come up with the "best" ethical solution. One of these ethical dilemmas is shown in **Table 2.1**. According to a recent survey by the Ethics Resource Center, more than 80 percent of U.S. companies provide some sort of ethics training for employees, which may include online activities, videos, and even games.[4]

An Ethical Dilemma Used for Employee Training
Bill Gannon was a middle manager of a large manufacturer of lighting fixtures in Newark, New Jersey. Bill had moved up the company ladder rather quickly and seemed destined for upper management in a few years. Bill's boss, Dana Johnson, had been pressuring him about the semiannual reviews concerning Robert Talbot, one of Bill's employees. Dana, it seemed, would not accept any negative comments on Robert's evaluation forms. Bill had found out that a previous manager who had given Robert a bad evaluation was no longer with the company. As Bill reviewed Robert's performance for the forthcoming evaluation period, he found many areas of subpar performance. Moreover, a major client had called recently complaining that Robert had filled a large order improperly and then had been rude to the client when she called to complain.

Table 2.1

An Ethical Dilemma Used for Employee Training
Discussion Questions 1. What ethical issues does the situation raise? 2. What courses of action could Bill take? Describe the ethics of each course. 3. Should Bill confront Dana? Dana's boss? 4. What would you do in this situation? What are the ethical implications?

Table 2.1

Establishing a Formal Code of Ethics

Most large companies and thousands of smaller ones have created, printed, and distributed codes of ethics. In general, a **code of ethics** provides employees with the knowledge of what their firm expects in terms of their responsibilities and behavior toward fellow employees, customers, and suppliers. Some ethical codes offer a lengthy and detailed set of guidelines for employees. Others are not really codes at all but rather summary statements of goals, policies, and priorities. Some companies have their codes framed and hung on office walls, included as a key component of employee handbooks, and/or posted on their corporate websites.

Examples of company codes of ethics:

Costco http://phx.corporate-ir.net/phoenix.zhtml?c=83830&p=irol-govhighlights
Starbucks https://www.starbucks.com/about-us/company-information/business-ethics-and-compliance
AT&T https://www.att.com/gen/investor-relations?pid=5595

Do codes of ethics make employees behave in a more ethical manner? Some people believe that they do. Others think that they are little more than public relations gimmicks. If senior management abides by the code of ethics and regularly emphasizes the code to employees, then it will likely have a positive influence on behavior.

The "100 Best Corporate Citizens" as ranked by *Corporate Responsibility* magazine are selected based on seven categories, including employee relations, human rights, corporate governance (including code of ethics), philanthropy and community support, financial performance, environment, and climate change.[5] The top corporate citizens in 2017 were:

1. Hasbro, Inc.
2. Intel Corp.
3. Microsoft Corp.
4. Altria Group, Inc.
5. Campbell Soup Company
6. Cisco Systems, Inc.
7. Accenture
8. Hormel Foods Corp.
9. Lockheed Martin Corp.
10. Ecolab, Inc.

CUSTOMER SATISFACTION AND QUALITY

Campbell's Adds CSR to Its Recipe

The Campbell Soup Company is no longer just about traditional cans of processed soup. Under the guidance of its management team, particularly its former CEO Denise Morrison (Morrison retired from Campbell's in July of 2018), Campbell's has undergone a transformation that includes a strong emphasis on organics and fresh food—and a large serving of corporate citizenship.

Named one of the Best Corporate Citizens by *Corporate Responsibility* magazine in 2017, Campbell's is working to make sustainability and transparency part of its business DNA, and this culture shift has had an important influence on the company's business strategies.

Morrison, who took over as CEO in 2011, is a firm believer in the company's central vision: real food that matters for life's moments. "We can make a profit and make a difference, and we are doing both through our business . . . in a way that's authentic, that's transparent, and that truly matters," she explains.

Under Morrison's watch, the company recently acquired several fresh food and organic companies, including Bolthouse Farms, one of the largest suppliers of fresh carrots in the United States, and Garden Fresh Gourmet, which produces a top line of fresh salsa and hummus. Tracking the strong change in consumer preference for healthier food, Campbell's also recently acquired Plum Organics, a line of organic baby food products, which should help solidify the company's reputation for fresh ingredients with millennials and their families.

The company's transformation from a processed food giant to a major competitor in the fresh food business has also had a positive influence on the company's bottom line. Campbell's shareholders have to be pleased with the 20 percent increase in the company's stock price over the past two years, as the markets, competitors, and consumers take notice of the company's strong commitment to sustainability.

Inherent in the company's reinvention is the strong emphasis on corporate citizenship—doing good and giving back seem to be top priorities for Campbell's. In addition to acquiring sustainable and fresh food companies, Campbell's has also made a conscious decision to support the communities where their employees live and work. For example, the company launched a healthy communities initiative in Camden, New Jersey, where Campbell's is headquartered—an urban city that has seen its share of economic and social challenges in the past. In partnership with several local organizations, this initiative has helped fund community gardens, food pantries, nutrition education, and cooking classes that help build healthy communities. The Camden experience has been so successful that the company has expanded the program to other cities where it operates, including Detroit, Michigan, and Norwalk, Connecticut.

The company's ongoing commitment to fresh food, community involvement, and corporate social responsibility has helped change the narrative when it comes to being a sustainable and ethical organization.

Questions for Discussion

1. How does Campbell Soup Company's recent business acquisitions help support its CSR strategies?
2. Provide examples of how the company's transformation from a processed food giant to a purveyor of fresh ingredients can help attract a new group of customers.

Sources: “Corporate Responsibility and Sustainability Are Good for Business,” https://www.campbellsoupcompany.com, accessed June 27, 2017; “Campbell Soup Wants to Make You a Personal Eating Plan (video),” *Fortune,* http://fortune.com, May 2, 2017; Don Seiffert, “Campbell Soup CEO Makes 3 Predictions about the Future of Food,” *Boston Business Journal,* http://www.bizjournals.com, April 13, 2017; Aaron Hurst, “How Denise Morrison Took Processed Food Icon Campbell’s on a Fresh Food Buying Spree,” *Fast Company,* https://www.fastcompany.com, March 2, 2017; Abigail Stevenson, “Campbell Soup CEO: Stunning Disruption in the Ecosystem of Food,” *CNBC,* http://www.cnbc.com, July 21, 2016.

Making the Right Decision

In many situations, there may be no simple right or wrong answers. Yet there are several questions you can ask yourself, and a couple of self-tests you can do, to help you make the right ethical decision. First, ask yourself, “Are there any legal restrictions or violations that will result from the action?” If so, take a different course of action. If not, ask yourself, “Does it violate my company’s code of ethics?” If so, again find a different path to follow. Third, ask, “Does this meet the guidelines of my own ethical philosophy?” If the answer is “yes,” then your decision must still pass two important tests.

The Feelings Test

You must now ask, “How does it make me feel?” This enables you to examine your comfort level with a particular decision. Many people find that, after reaching a decision on an issue, they still experience discomfort that may manifest itself in a loss of sleep or appetite. Those feelings of conscience can serve as a future guide in resolving ethical dilemmas.

The Newspaper or Social Media Test

The final test involves the front page of the newspaper or social media posts. The question to be asked is how an objective reporter would describe your decision in a front-page newspaper story, an online media site, or a social media platform such as Twitter or Facebook. Some managers rephrase the test for their employees: How will the headline read if I make this decision, or what will be the reaction of my social media followers? This test is helpful in spotting and resolving potential conflicts of interest.

Exhibit 2.3 Making an ethical decision might come down to how you feel about the decision or to the newspaper or social media post test. The question to ask yourself is how the decision would make you feel if an objective reporter described the decision on the front page of a newspaper or via a social media post on Twitter or Facebook—all of which would be viewed by many, many people. Speaking of social media, it plays a pivotal role in ethical decision-making today, when people use the medium to share critical comments about friends as well as employers, business colleagues, and competitors. *Should companies view employees' social media pages on a regular basis, or is that information off-limits to employers?* (Credit: Mike MacKenzie/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

CONCEPT CHECK

1. What is the role of top management in organizational ethics?
2. What is a code of ethics?

2.3 Managing a Socially Responsible Business

3. What is corporate social responsibility?

Acting in an ethical manner is one of the four components of the pyramid of **corporate social responsibility (CSR),** which is the concern of businesses for the welfare of society as a whole. It consists of obligations beyond those required by law or union contract. This definition makes two important points. First, CSR is voluntary. Beneficial action required by law, such as cleaning up factories that are polluting air and water, is not voluntary. Second, the obligations of corporate social responsibility are broad. They extend beyond investors in the company to include workers, suppliers, consumers, communities, and society at large.

Exhibit 2.4 portrays economic responsibility as the foundation for the other three responsibilities. At the same time that a business pursues profits (economic responsibility), however, it is expected to obey the law (legal responsibility); to do what is right, just, and fair (ethical responsibility); and to be a good corporate citizen (philanthropic responsibility). These four components are distinct but together constitute the whole. Still, if the company doesn't make a profit, then the other three responsibilities won't matter.

Many companies continue to work hard to make the world a better place to live. Recent data suggests that Fortune 500 companies spend more than $15 billion annually on CSR activities. Consider the following examples:

- Starbucks has donated more than one million meals to local communities via its FoodShare program and alliance with Feeding America, giving 100 percent of leftover food from their seven thousand U.S. company-owned stores.
- Salesforce encourages its employees to volunteer in community activities and pays them for doing so, up to 56 paid hours every year. For employees who participate in seven days of volunteerism in one year, Salesforce also gives them a $1,000 grant to donate to the employee's nonprofit of choice.
- Employees who work for Deloitte, a global audit, consulting, and financial services organization, can get paid for up to 48 hours of volunteer work each year. In a recent year, more than 27,000 Deloitte professionals contributed more than 353,000 volunteer hours to their communities around the world.[6]

Understanding Social Responsibility

Peter Drucker, the late globally respected management expert, said that we should look first at what an organization does *to* society and second at what it can do *for* society. This idea suggests that social responsibility has two basic dimensions: legality and responsibility.

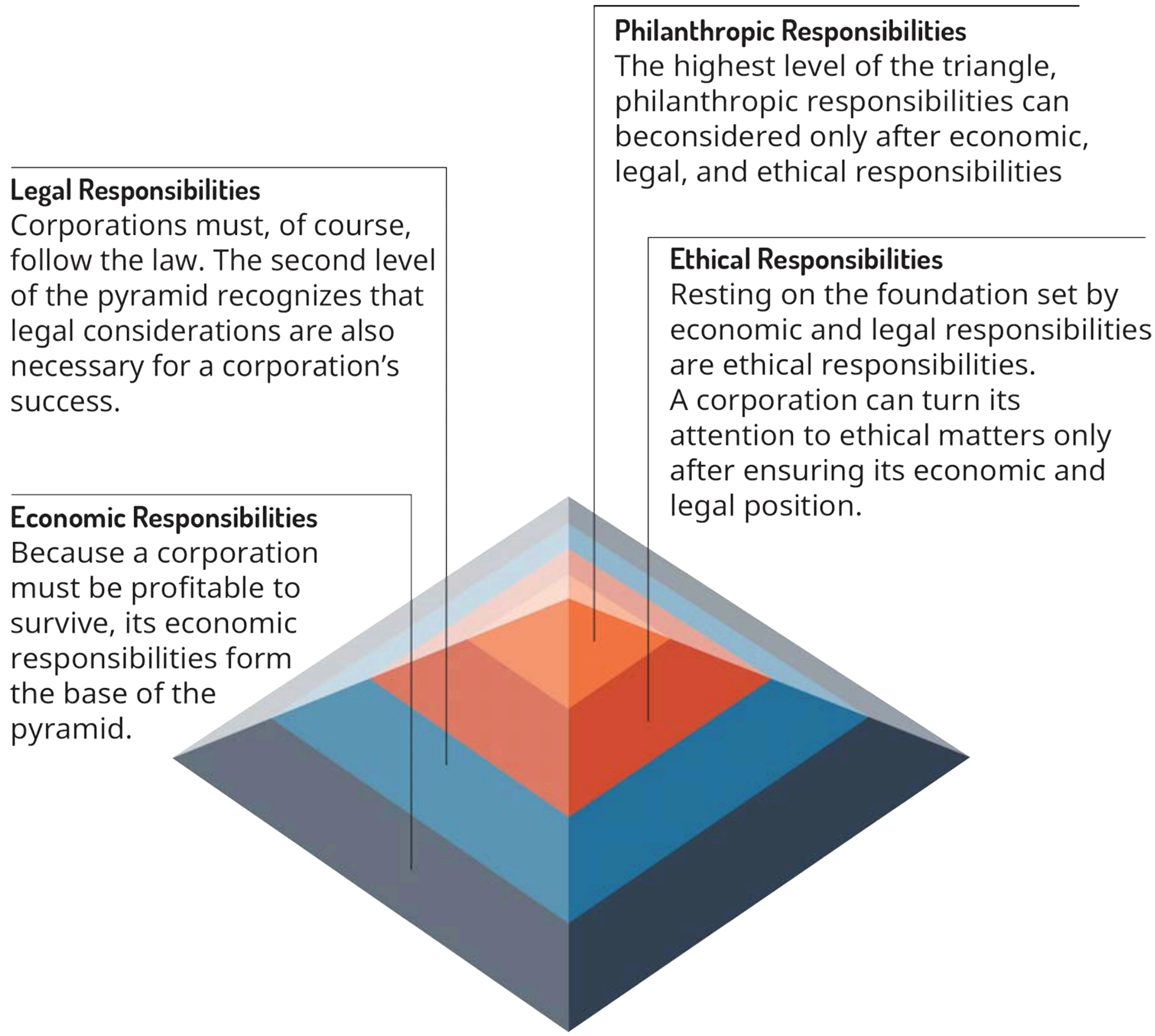

Exhibit 2.4 The Pyramid of Corporate Social Responsibility (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

Illegal and Irresponsible Behavior

The idea of corporate social responsibility is so widespread today that it is hard to conceive of a company continually acting in illegal and irresponsible ways. Nevertheless, such actions do sometimes occur, which can create financial ruin for organizations, extreme financial hardships for many former employees, and general struggles for the communities in which they operate. Unfortunately, top executives still walk away with millions. Some, however, will ultimately pay large fines and spend time in prison for their actions. Federal, state, and local laws determine whether an activity is legal or not. The laws that regulate business are discussed later in this module.

Irresponsible but Legal Behavior

Sometimes companies act irresponsibly, yet their actions are legal. For example, the Minnesota-based company that makes MyPillow was recently fined $1 million by the state of California for making unsubstantiated claims that the “most comfortable pillow you’ll ever own” could help alleviate medical conditions such as snoring, fibromyalgia, migraines, and other disorders. The company’s CEO countered that the claims were actually made by customers; these testimonials were posted on the company’s website but later removed. In addition to the fine, the company faced several class-action lawsuits, and the Better Business Bureau has revoked MyPillow’s accreditation.[7]

CATCHING THE ENTREPRENEURIAL SPIRIT

Badger Company Founder Walks the Walk

As a carpenter, Bill Whyte was always looking for a solution to his dry, cracked hands, especially in the harsh New Hampshire winters. After trying many commercial lotions that didn’t really work, Whyte experimented with olive oil and beeswax to come up with a soothing balm to help heal rough hands. Mixing up the concoction at home, Whyte came up with a product that seemed to work and was made from natural ingredients.

Originally called Bear Paw, the lotion became known as Badger Balm after a friend found a competing product already named Bear Paw. Whyte set up a production line at home to fill the tins. Soon he was pounding the pavement in the town of Gilsum, trying to sell the new product to hardware stores, lumber yards, and health food stores.

Fast-forward a little more than 20 years from his early days of experimentation, and Whyte (affectionately known as the “head badger”) runs W.S. Badger Company with the same goals and passions he started with back in the mid-1990s. The company uses only organic plant extracts, exotic oils, beeswax, and minerals to make the most effective products to soothe, heal, and protect the body. And the natural ingredients come from all over the world—for example, organic extra virgin olive oil from Spain, organic rose essential oil from Bulgaria, and bergamot oil from southern Italy.

Badger’s homey culture is no accident. In fact, in the early days, Whyte made soup every Friday for the small staff. Today, Whyte and family members, including his wife Kathy, chief operating officer; daughter Rebecca, head of sustainability and innovation; and daughter Emily, head of sales and marketing, all embrace the ethical and social principles of this family business that have made the company a success.

To reinforce the commitment of being socially responsible and demonstrating transparency, W.S. Badger Company became a Certified Benefit Corporation, or B Corp for short. This certification requires companies to meet rigorous standards for transparency, accountability, and social and environmental performance. (Benefit Corporations are discussed in more detail later in this module.)

Becoming a B Corp. has helped the company organize how it operates. For example, pay for the highest-paid full-time employee is capped at five times that of the lowest paid, which is now $15 an hour (more than double New Hampshire’s minimum wage); a portion of company profits flows to employees via profit sharing, and all employees participate in a bonus plan; and new parents are encouraged to bring their babies to work, a program that has helped foster a new style of teamwork for the entire organization, as well as increase employee morale. In addition, Badger donates 10 percent of its pre-tax profits annually to nonprofit organizations that focus on the health and welfare of children, matches employee contributions to charitable causes (up to $100 per employee), and donates an additional $50 to a nonprofit chosen by each employee on their birthday.

Badger staff, which now number more than 100, enjoy a living wage, great benefits, and a socially responsible work environment thanks to a visionary who found an eco-friendly way to soothe his rough hands and created an ethical business as part of his journey.

Questions for Discussion

1. How does Badger's approach to social responsibility help attract and retain employees?
2. Does the company's certification as a Benefit Corporation provide Badger with a competitive advantage? Explain your reasoning.

Sources: "Badger's History & Legend," "Babies at Work Policy," and "2016 Annual Impact Report," https://www.badgerbalm.com, accessed June 27, 2017; "About Badger," https://www.bcorporation.net, accessed June 27, 2017; "Badger 'Still In' on Climate Action, Asks New Hampshire Businesses, State Officials, and Local Leaders to Join Forces in Honoring Paris Agreement," http://www.prweb.com, June 22, 2017; Amy Feldman, "Badger Balm Creator Once Dismissed Being a B Corp as 'Just Marketing.' Now He's a True Believer," *Forbes,* http://www.forbes.com, May 9, 2017.

Legal and Responsible Behavior

The vast majority of business activities fall into the category of behavior that is both legal and responsible. Most companies act legally, and most try to be socially responsible. Research shows that consumers, especially those under 30, are likely to buy brands that have excellent ethical track records and community involvement. Outdoor specialty retailer REI, for example, recently announced that it gave back nearly 70 percent of its profits to the outdoor community. A member cooperative, the company invested a record $9.3 million in its nonprofit partners in 2016.[8]

CONCEPT CHECK

1. What are the four components of social responsibility?
2. Give an example of legal but irresponsible behavior.

2.4 Responsibilities to Stakeholders

4. How do businesses meet their social responsibilities to various stakeholders?

What makes a company be admired or perceived as socially responsible? Such a company meets its obligations to its stakeholders. **Stakeholders** are the individuals or groups to whom a business has a responsibility. The stakeholders of a business are its employees, its customers, the general public, and its investors.

Responsibility to Employees

An organization's first responsibility is to provide a job to employees. Keeping people employed and letting them have time to enjoy the fruits of their labor is the finest thing business can do for society. Beyond this fundamental responsibility, employers must provide a clean, safe working environment that is free from all forms of discrimination. Companies should also strive to provide job security whenever possible.

Enlightened firms are also empowering employees to make decisions on their own and suggest solutions to company problems. Empowerment contributes to an employee's self-worth, which, in turn, increases productivity and reduces absenteeism.

Each year, in collaboration with Great Place to Work®, *Fortune* conducts an extensive employee survey of the best places to work in the United States. For 2017, the top companies included Google, Wegmans Food Markets, Edward Jones, Genentech, Salesforce, Acuity, and Quicken Loans. Some companies offer unusual benefits to their employees. For example, biotech company Genentech offers employee compensation for taking alternative methods of transportation to work at its South San Francisco campus. Employees can earn $12 per day for walking or biking to work, and those who drive a carpool or vanpool can earn $8 and $16, respectively. In addition, the company offers free commuter bus service for all employees via 27 routes around the Bay Area.[9]

Responsibility to Customers

To be successful in today's business environment, a company must satisfy its customers. A firm must deliver what it promises, as well as be honest and forthright in everyday interactions with customers, suppliers, and others. Recent research suggests that many consumers, particularly millennials, prefer to do business with companies and brands that communicate socially responsible messages, utilize sustainable manufacturing processes, and practice ethical business standards.[10]

Responsibility to Society

A business must also be responsible to society. A business provides a community with jobs, goods, and services. It also pays taxes that go to support schools, hospitals, and better roads. Some companies have taken an additional step to demonstrate their commitment to stakeholders and society as a whole by becoming Certified Benefit Corporations, or B Corps for short. Verified by B Lab, a global nonprofit organization, B Corps meet the highest standards of social and environmental performance, public transparency, and legal accountability and strive to use the power of business to solve social and environmental problems via an impact assessment that rates each company on a possible score of 200 points. To become certified as a Benefit Corporation, companies need to reach a score of at least 80 and must be recertified every two years. There are more than 2,000 companies worldwide that have been certified as B Corps, including Method, W.S. Badger Company, Fishpeople Seafood, LEAP Organics, New Belgium Brewing Company, Ben & Jerry's, Cabot Creamery Co-op, Comet Skateboards, Etsy, Patagonia, Plum Organics, and Warby Parker.[11]

Environmental Protection

Business is also responsible for protecting and improving the world's fragile environment. The world's forests are being destroyed fast. Every second, an area the size of a football field is laid bare. Plant and animal species are becoming extinct at the rate of 17 per hour. A continent-size hole is opening up in the earth's protective ozone shield. Each year we throw out 80 percent more refuse than we did in 1960; as a result, more than half of the nation's landfills are filled to capacity.

To slow the erosion of the world's natural resources, many companies have become more environmentally responsible. For example, Toyota now uses renewable energy sources such as solar, wind, geothermal, and water power for electricity to run its facilities. When its new $1 billion North American headquarters opened in Plano, Texas, in May 2017, Toyota said the 2.1 million square-foot campus would eventually be powered by 100% clean energy, helping the auto giant move closer to its goal of eliminating carbon emissions in all of its operations.[12]

ETHICS IN PRACTICE

This Fish Story Has a Tasting Ending

Duncan Berry has always been an environmentalist at heart. Brought up on the Oregon coast, he was a sea captain at an early age, spending nearly two decades on the ocean before going on to become a successful entrepreneur in the organic cotton industry. After selling the textile business at the age of 50, he retired back to the Oregon coast to work on a state initiative to preserve marine habitats.

He quickly discovered that the state's commercial fishing industry had gone into major disrepair since his seafaring adventure years earlier. Berry learned the majority of seafood consumed in the United States was being imported from other countries and more than 90 percent of U.S. seafood was being exported. In addition, great harm was being done to the ocean because it was being overfished.

Although several groups were already working to improve the commercial fishing industry, he observed that one key group was not part of the discussion: consumers. Berry decided a key component of change had to be involving consumers in the process. He spent more than a year meeting with everyone involved in the Oregon fishing industry—from fishermen to processors, distributors, truck drivers, chefs, and consumers—to gain perspective on why the industry was failing. His "aha" moment occurred when he realized the majority of fish is consumed in restaurants because consumers think preparing fish at home is too difficult and time-consuming. That's when he co-founded Fishpeople Seafood.

Started in 2012, Fishpeople has a mission of changing the way people think about seafood by being transparent about where the seafood comes from, how it is processed, and how it is handled. Berry believes the company's transparency helps consumers understand how the process translates into sustainable food that tastes good and is good for you. The company makes shelf-stable, ready-to-eat restaurant-quality seafood in the form of soups, meal kits, and fresh and frozen filets, complete with farm-to-table ingredients. On every package there is a code consumers can enter at the company's website that will tell them everything about the seafood's origin, down to the fisherman who caught it. Fishpeople also operates a processing plant in Toledo, Oregon, where workers are paid a livable wage and receive health insurance—benefits typically unheard of in the fishing industry.

Fishpeople's products are available in more than 5,000 stores nationwide, including Walmart, Whole Foods, Costco, Kroger, and other grocery stores and markets. Recently the company announced a merger with Ilwaco Landing Fishermen, which will help further the two groups' shared vision of supporting local fishermen and providing sustainable seafood to consumers.

Questions for Discussion

1. How does Fishpeople's transparency contribute to the company's success?
2. What responsibility, if any, does Fishpeople have to the local fishing industry?

Sources: Company website, https://fishpeopleseafood.com, accessed June 27, 2017; J. David Santen, Jr., "Adding Value to Oregon Seafood," *Built Oregon,* http://builtoregon.com, accessed June 27, 2017; Elizabeth Crawford, "Fishpeople Wants to Fix the 'Fundamentally Broken' Seafood Industry with Increased Transparency," *Food Navigator,* http://www.foodnavigator-usa.com, May 25, 2017; Fishpeople Seafood Announces Merger with Ilwaco Landing Fishermen," *Tillamook County Pioneer*, https://www.tillamookcountypioneer.net, May 22, 2017; Leigh Buchanan, "Why This Entrepreneur Ditched Fashion for the 'Hunting and Gathering' Business," *Inc.,* https://www.inc.com, April 2017 issue; Kate Harrison, "This Former Green Textile Maven Is Making Microwaved Seafood Sustainable," *Forbes,* http://www.forbes.com, August 25, 2015.

Corporate Philanthropy

Companies also display their social responsibility through corporate philanthropy. **Corporate philanthropy** includes cash contributions, donations of equipment and products, and support for the volunteer efforts of company employees. Recent statistics suggest U.S. corporate philanthropy exceeds more than $19 billion annually.[13] American Express is a major supporter of the American Red Cross. The organization relies almost entirely on charitable gifts to carry out its programs and services, which include disaster relief, armed-forces emergency relief, blood and tissue services, and health and safety services. The funds provided by American Express have enabled the Red Cross to deliver humanitarian relief to victims of numerous disasters around the world.[14] When Hurricane Katrina hit the Gulf Coast, Bayer sent 45,000 diabetes blood glucose monitors to the relief effort. Within weeks of the disaster, Abbott, Alcoa, Dell, Disney, Intel, UPS, Walgreens, Walmart, and others contributed more than $550 million for disaster relief.[15]

Exhibit 2.5 Hybrid cars and all-electric vehicles such as Tesla models are turning heads and changing the way the world drives. Electric vehicles are more eco-friendly, but they are also more expensive to own. Analysts project that after charging, insurance, and maintenance costs, electric cars cost thousands of dollars more than conventional vehicles. *Do the environmental benefits associated with electric cars justify the higher cost of ownership?* (Credit: Steve Jurvetson/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Responsibilities to Investors

Companies' relationships with investors also entail social responsibility. Although a company's economic responsibility to make a profit might seem to be its main obligation to its shareholders, some investors increasingly are putting more emphasis on other aspects of social responsibility.

Some investors are limiting their investments to securities (e.g., stocks and bonds) that coincide with their beliefs about ethical and social responsibility. This is called **social investing**. For example, a social investment fund might eliminate from consideration the securities of all companies that make tobacco products or liquor, manufacture weapons, or have a history of being environmentally irresponsible. Not all social investment strategies are alike. Some ethical mutual funds will not invest in government securities because they help to fund the military; others freely buy government securities, with managers noting that federal funds also support the arts and pay for AIDS research. Today, assets invested using socially responsible strategies total more than $7 trillion.[16]

Perhaps partly as the result of the global recession of 2007–2009, over the last several years companies have tried to meet responsibilities to their investors as well as to their other stakeholders. Recent research suggests that now more than ever, CEOs are being held to higher standards by boards of directors, investors, governments, media, and even employees when it comes to corporate accountability and ethical behavior. A recent global study by PwC reveals that over the last several years, there has been a large increase in the number of CEOs being forced out due to some sort of ethical lapse in their organizations. Strategies to prevent such missteps should include establishing a culture of integrity to prevent anyone from breaking the rules, making sure company goals and metrics do not create undue pressure on employees to cut corners, and implementing effective processes and controls to minimize the opportunity for unethical behavior.[17]

CONCEPT CHECK

1. How do businesses carry out their social responsibilities to consumers?
2. What is corporate philanthropy?
3. Is a company's only responsibility to its investors to make a profit? Why or why not?

2.5 Trends in Ethics and Corporate Social Responsibility

5. What are the trends in ethics and corporate social responsibility?

Three important trends related to ethics and corporate social responsibility are strategic changes in corporate philanthropy, a new social contract between employers and employees, and the growth of global ethics and corporate social responsibility.

Changes in Corporate Philanthropy

Historically, corporate philanthropy has typically involved companies seeking out charitable groups and giving them money or donating company products or services. Today, the focus has shifted to **strategic giving**, which ties philanthropy and corporate social responsibility efforts closely to a company's mission or goals and targets donations to the communities where a company does business. Some of the top businesses recognized for their efforts in giving back to the communities in which they operate include technology giant Salesforce, San Antonio's NuStar Energy, insurance and financial services firm Veterans United, and software leader Intuit.[18]

A Social Contract between Employer and Employee

Another trend in social responsibility is the effort by organizations to redefine their relationship with their employees. Many people have viewed social responsibility as a one-way street that focuses on the obligations of business to society, employees, and others. Now, companies recognize that the social contract between employer and employee is an important aspect of the workplace and that both groups have to be committed to working together in order for the organization to prosper. The social contract can be defined in terms of four important aspects: compensation, management, culture, and learning and development.[19]

When it comes to compensation, companies today must recognize that most employees do not stay with one organization for decades. Thus, companies need to change their compensation structure to acknowledge the importance of short-term performance and to update their methods for determining compensation, including benefits and other nontraditional perks such as increased paid leave and telecommuting options.

In the current workplace environment, where employees are likely to jump to new jobs every couple years, managers need to take a more active and engaged approach to supervising employees and perhaps change the way they think about loyalty, which may be difficult for managers used to supervising the same group of employees for a long period of time. Engaging employees on a regular basis, setting realistic expectations, and identifying specific development paths may help retain key employees.

Thanks to today's tight labor market, some employees feel empowered to demand more from their employer and its overall culture via strategies such as increased flexibility, transparency, and fairness. This increased importance of the employee’s role in the company’s culture helps workers stay engaged in the mission of the organization and perhaps makes them less likely to look elsewhere for employment.

Finally, rapidly changing technology used in today’s workplace continues to shift the learning and development component of the employer-employee contract, causing immense challenges to both companies and workers. It may be more difficult to identify the employee skills that will be critical over the next several years, causing employers either to increase training of current workers or to look outside the organization for other individuals who already possess the technical skills needed to get the job done.

Global Ethics and Social Responsibility

When U.S. businesses expand into global markets, they must take their codes of ethics and policies on corporate social responsibility with them. As a citizen of several countries, a multinational corporation has several responsibilities. These include respecting local practices and customs, ensuring that there is harmony between the organization’s staff and the host population, providing management leadership, and developing a solid group of local managers who will be a credit to their community. When a multinational firm makes an investment in a foreign country, it should commit to a long-term relationship. That means involving all stakeholders in the host country in decision-making. Finally, a responsible multinational will implement ethical guidelines within the organization in the host country. By fulfilling these responsibilities, the company will foster respect for both local and international laws.

Multinational corporations often must balance conflicting interests of stakeholders when making decisions regarding social responsibilities, especially in the area of human rights. Questions involving child labor, forced labor, minimum wages, and workplace safety can be particularly difficult. Recently Gap, Inc. decided to publish the list of its global factories in an effort to provide transparency about its suppliers and the efforts the company continues to make to improve working conditions around the world. The company has partnered with Verité, a nongovernmental organization focused on ensuring that people work under safe, fair, and legal conditions. By soliciting feedback from factory workers making its products, Gap is hoping to improve working conditions and help these factories become leaders in their local communities.[20]

CONCEPT CHECK

1. Describe strategic giving.
2. What role do employees have in improving their job security?
3. How do multinational corporations demonstrate social responsibility in a foreign country?

Key Terms

code of ethics A set of guidelines prepared by a firm to provide its employees with the knowledge of what the firm expects in terms of their responsibilities and behavior toward fellow employees, customers, and suppliers.

corporate philanthropy The practice of charitable giving by corporations; includes contributing cash, donating equipment and products, and supporting the volunteer efforts of company employees.

corporate social responsibility (CSR) The concern of businesses for the welfare of society as a whole; consists of obligations beyond those required by law or contracts.

deontology A philosophy in which a person will follow his or her obligations to an individual or society because upholding one's duty is what is ethically correct.

ethical issue A situation where a person must choose from a set of actions that may be ethical or unethical.

ethics A set of moral standards for judging whether something is right or wrong.

justice What is considered fair according to the prevailing standards of society; an equitable distribution of the burdens and rewards that society has to offer.

social investing The practice of limiting investments to securities of companies that behave in accordance with the investor’s beliefs about ethical and social responsibility to encourage businesses to be more socially responsible.

stakeholders Individuals or groups to whom a business has a responsibility; include employees, customers, the general public, and investors.

strategic giving The practice of tying philanthropy and corporate social responsibility efforts closely to a company’s mission or goals and targeting donations to the communities where a company does business.

utilitarianism A philosophy that focuses on the consequences of an action to determine whether it is right or wrong; holds that an action that affects the majority adversely is morally wrong.

Summary of Learning Outcomes

2.1 Understanding Business Ethics

1. What philosophies and concepts shape personal ethical standards?

Ethics is a set of moral standards for judging whether something is right or wrong. A utilitarianism approach to setting personal ethical standards focuses on the consequences of an action taken by a person or organization. According to this approach, people should act so as to generate the greatest good for the greatest number. Every human is entitled to certain rights such as freedom and the pursuit of happiness. Another approach to ethical decision-making is justice, or what is fair according to accepted standards.

2.2 How Organizations Influence Ethical Conduct

2. How can organizations encourage ethical business behavior?

Top management must shape the ethical culture of the organization. They should lead by example, offer ethics-training programs, and establish a formal code of ethics.

2.3 Managing a Socially Responsible Business

3. What is corporate social responsibility?

Corporate social responsibility is the concern of businesses for the welfare of society as a whole. It consists of obligations beyond just making a profit and goes beyond what is required by law or union contract.

Companies may engage in illegal and irresponsible behavior, irresponsible but legal behavior, or legal and responsible behavior. The vast majority of organizations act legally and try to be socially responsible.

2.4 Responsibilities to Stakeholders

4. How do businesses meet their social responsibilities to various stakeholders?

Stakeholders are individuals or groups to whom business has a responsibility. Businesses are responsible to employees. They should provide a clean, safe working environment. Organizations can build employees' self-worth through empowerment programs. Businesses also have a responsibility to customers to provide good, safe products and services. Organizations are responsible to the general public to be good corporate citizens. Firms must help protect the environment and provide a good place to work. Companies also engage in corporate philanthropy, which includes contributing cash, donating goods and services, and supporting volunteer efforts of employees. Finally, companies are responsible to investors. They should earn a reasonable profit for company owners.

2.5 Trends in Ethics and Corporate Social Responsibility

5. What are the trends in ethics and corporate social responsibility?

Today, corporate philanthropy is shifting away from simply giving to any needy group and is focusing instead on strategic giving, in which the philanthropy relates more closely to the corporate mission or goals and targets donations to areas where the firm operates.

A second trend is toward a new social contract between employer and employee. Instead of the employer having the sole responsibility for maintaining jobs, now the employee must assume part of the burden and find ways to add value to the organization.

As the world increasingly becomes a global community, multinational corporations are now expected to assume a global set of ethics and responsibility. Global companies must understand local customs. They should also involve local stakeholders in decision-making. Multinationals must also make certain that their suppliers are not engaged in human rights violations.

Preparing for Tomorrow's Workplace Skills

1. Many CEOs have sold shares of their company's stock when prices were near their high points. Even though their actions were legal, it soon became apparent that they knew that the stock was significantly overpriced. Was the CEO ethically obligated to tell the public that this was the case—even knowing that doing so could cause the stock price to plummet, thereby hurting someone who bought the stock earlier that day? (Systems)
2. Jeffrey Immelt, former chairman and CEO of General Electric, one of the world's most-admired companies according to *Fortune* magazine, says that execution, growth, and great people are required to keep the company on top. Immelt said that these are predictable, but a fourth factor is not—virtue, and virtue was at the top of his list. Using a search engine, find articles on what GE is doing to enhance its corporate citizenship. Report your findings to the class. Could GE do more, or are they already doing too much? Why? (Systems, Technology)
3. Boeing Corp. makes business ethics a priority, asking employees to take refresher training every year. It encourages employees to take the Ethics Challenge with their work groups and to discuss the issues with their peers. You can take your own ethics challenge. Go to **http://www.ethics.org** and click on the Ethics Effectiveness Quick Test. Summarize your findings. Were there any answers that surprised you? (Information)

4. Identify the potential ethical and social responsibility issues confronting the following organizations: Microsoft, Pfizer, Nike, American Cancer Society, and R.J. Reynolds. Make recommendations on how these issues should be handled. (Systems)
5. **Team Activity** Divide the class into teams. Debate whether the only social responsibility of the employer to the employee is to provide a job. Include a discussion of the employee's responsibility to bring value to the firm. Also, debate the issue of whether the only social responsibility of a firm is to earn a profit. (Interpersonal)

Ethics Activity

Let's Be Honest

The Honest Company is a consumer-goods business that sells nontoxic, eco-friendly items for baby and personal care, household cleaning, and a healthy lifestyle. Cofounded by actress Jessica Alba a little more than six years ago, Honest Co. is built on the promise of "telling all and doing our best to live up to your expectations."

Over the years the company has received high praise and media buzz about its ethical approach to making products that are not only good for people but good for the environment. On its website, Honest Co. goes to great lengths to share with consumers its guiding principles that products are made without harming people or the planet.

A little over two years ago, however, the company experienced some bad press when *The Wall Street Journal* reported that two independent lab tests found samples of Honest laundry detergent contained a cleaning agent on the list of chemicals the company pledged to avoid. At first, pushback from company officials was loud and clear: they denied their products were anything but eco-friendly and safe for consumers and went as far as calling the report "false" and "junk science."

Unfortunately, the reports about Honest products and their harmful ingredients didn't go away. After the laundry detergent story faded, the company quietly reconfigured the ingredients that went into the detergent as well as other products. But that wasn't the end of the story. Several months later, Honest Co. voluntarily recalled organic baby powder that might cause infections and more recently recalled diaper wipes that appeared discolored.

Despite these recent challenges, Honest Co. continues to be successful and was rumored to be on the short list of possible acquisitions for global conglomerates such as Procter & Gamble, Johnson & Johnson, and Unilever. These consumer-good giants are snapping up smaller, eco-friendly firms that have blossomed into full-fledged ethically and environmentally conscious organizations with strong sales and solid reputations among consumers. Recently, however, Unilever acquired one of Honest Co.'s biggest rivals, Seventh Generation, Inc., leaving Honest Co. to again rethink its business strategies, including hiring a new CEO.

Using a web search tool, locate information about this topic and then write responses to the following questions. Be sure to support your arguments and cite your sources.

Ethical Dilemma: Do you think the company's reaction to reports of hazardous ingredients hurt its reputation for honesty and ethical behavior? Do you think the company's missteps caused Unilever to shy away from acquiring the company? Or, do you take the stance that Alba's entertainment background played a part in the press going after the company? If you were an advisor to the new CEO, what suggestions would you give him for getting the company back on track, especially when it comes to corporate social responsibility?

Sources: "Our Principles," https://www.honest.com, accessed June 27, 2017; Eun Kyung Kim, "Jessica Alba's Honest Company Recalls Diaper Wipes over Mold Concerns," *Today,* http://www.today.com, May 16, 2017; Steve Tobak, "Jessica Alba's 'Honest' Mess," *Entrepreneur,* https://www.entrepreneur.com, March 29, 2017; Jason Del Rey, "Jessica Alba's Honest Company Is Replacing Its CEO after a Sale to Unilever Fell Through," *Recode,* https://www.recode.net, March 16, 2017; Serena Ng, "Jessica Alba's Honest Co. to Drop Use of Disputed Ingredient," *The Wall Street Journal,* http://www.wsj.com, September 30, 2016; Kathryn Vasel, "The Honest Company Gets Sued . . . Again," *CNN Money,* http://money.cnn.com, April 27, 2016.

Working the Net

1. You will find the listing for the 100 Best Corporate Citizens at the website for *Corporate Responsibility* magazine (**http://thecro.com).** Review the current list of companies and pay close attention to those marked with a "yellow card" caution and a "red card" caution. These are companies that have either been removed from the list due to unethical behavior or have been warned that some of their actions border on unethical. What surprised you about the companies that have been flagged? Select one of the flagged companies and explain what they can do to improve their CSR profile.
2. Richard S. Scrushy, former CEO of HealthSouth Corporation, was charged with $1.4 billion in fraud. He was acquitted. Bernie Ebbers, former CEO of WorldCom, was found guilty of helping mastermind an $11 billion accounting fraud. Go to the internet and read several articles about the charges against both men. Find articles on why one was guilty on all counts and the other acquitted on all counts. Explain the ethical issues involved with each.
3. Visit the website of People for the Ethical Treatment of Animals (PETA), **http://peta.org**, and under the Issues tab, read about PETA's view of Animals Used for Clothing. Do you agree with this view? Why or why not? How do you think manufacturers of fur clothing would justify their actions to someone from PETA? Would you work for a store that sold fur-trimmed clothing? Explain your answer.
4. Green Money Journal, **http://www.greenmoneyjournal.com**, is a bimonthly online journal that promotes socially responsibility investing. What are the current topics of concern in this area? Visit the archives to find articles on socially responsible investing and two areas of corporate social responsibility. Summarize what you have learned.
5. Double the Donation, **https://doublethedonation.com**, is a website that provides information on top forms of corporate philanthropy and highlights companies with strong giving programs. Research several companies and their philanthropic activities and provide details about what makes these organizations excellent corporate citizens.

Critical Thinking Case

Uber Hits a Bumpy Road

Uber Technologies, Inc. is the world's largest technology start-up, valued at close to $70 billion. But that doesn't mean it has been smooth sailing for the ride-hailing company since its start in 2009. Despite disrupting and revolutionizing the transportation industry in a short period of time, Uber's meteoric rise has caused some shortcuts in organizational structure, corporate culture, and effective HR practices that have left the company with self-inflicted wounds that may take a long time to heal.

Uber has experienced several scandals over the past few years, including drivers demanding to be classified as employees (not contractors), a tool called "greyball" that allows data collected from the Uber app to identify and avoid enforcement officers trying to catch Uber drivers in cities where the service was illegal, and recent resignations of top executives, including the company's president and the heads of product development and engineering. But nothing has been quite as damaging as a recent blog post by a former female employee, which detailed the inappropriate behavior that seemed to be commonplace in Uber's workplace culture.

The allegations of sexual harassment put forth by former Uber engineer Susan Fowler were explosive. Detailed in a February 2017 blog post, Fowler says she alerted company HR about her manager's inappropriate behavior, even taking screenshots of his suggestive emails, but Fowler was told her boss would not be fired for sexual harassment because he was a "high performer" for the company. After Fowler's story went public, the company hired former U.S. attorney Eric Holder to investigate the allegations and other workplace issues. Holder's recommendations, which the Uber board of directors unanimously approved, include changes to senior leadership, enhanced oversight by the company's board, changes to the company's internal financial and audit controls, revisions to the company's cultural values, mandatory leadership training for senior executives and other managers, improvements to the overall HR function and complaint process, and the establishment of an employee diversity advisory board. In addition, as the result of a separate investigation, Uber fired more than 20 other people because of harassment claims.

With increasing pressure from the company's board and other investors, CEO Travis Kalanick said he would take a leave of absence while still mourning the unexpected death of his mother in a recent boating accident. However, most board members lost faith that Kalanick would be able to come back after his leave and make things better. At the urging of the board, two venture capitalists were dispatched to Chicago, where Kalanick was interviewing COO candidates, to present him with a letter from five of Uber's major investors demanding his resignation. After hours of discussion, Kalanick agreed to step down. According to an Uber spokesperson, a committee of 14 executives is running the company until a new CEO is hired.

Critical Thinking Questions

1. According to recent data, only 36 percent of Uber's current employees are women. How do you think this situation helped perpetuate a flawed corporate culture?
2. What can Uber do to ensure its competitors are not chipping away at its dominant market share as a result of such bad press?
3. Do you think installing an experienced female CEO would help the company change its culture and workplace environment? Explain your reasoning.

Sources: Marisa Kendall, "Uber: Here's Who's Running the Show Now," *Mercury News*, http://www.mercurynews.com, June 23, 2017; Eric Newcomer, "Uber CEO Travis Kalanick Quits Under Pressure from Investors," *Bloomberg News,* https://www.bloomberg.com, June 21, 2017; Mike Issac, "Inside Travis Kalanick's Resignation as Uber's C.E.O.," *The New York Times,* http://www.nytimes.com, June 21, 2017; "Holder Recommendations on Uber," *The New York Times,* https://www.nytimes.com, June 13, 2017; Eric Newcomer, "Uber Fires More Than 20 Employees in Harassment Probe," *Bloomberg Technology,* https://www.bloomberg.com, June 6, 2017; Erin Griffith, "The Uncomfortable Reality Behind Uber's Culture Meltdown," *Fortune,* http://fortune.com, April 20, 2017; Johana Bhuiyan, "Uber Has Published Its Much Sought After Diversity Numbers for the First Time," *Recode,* https://www.recode.net, March 28, 2017; Marco della Cava, "Uber President Quits as Company Searches for COO," *USA Today,* https://www.usatoday.com, March 20, 2017; Mike Isaac, "How Uber Deceives the Authorities Worldwide," *The New York Times,* http://www.nytimes.com, March 3, 2017; Susan J. Fowler, "Reflecting on One Very, Very Strange Year at Uber," https://www.susanjfowler.com/blog, February 19, 2017.

Hot Links Address Book

1. Find out which companies test their products on animals and which don't in the campaign section of the PETA website, **http://www.peta.org**.
2. How is the International Business Ethics Institute working to promote business ethics worldwide? Find out at **http://www.business-ethics.org**.
3. Ben & Jerry's ice cream has always taken its responsibilities as a corporate good citizen seriously. Learn about the company's positions on various issues and products that support social issues at its website, **http://www.benjerry.com**.
4. Discover what the Texas Instruments employee Ethics Quick Test includes, as well as the company's overall ethics policies, by searching for "Ethics at TI" on the corporate home page, **http://www.ti.com**.
5. What does IBM require from its employees in terms of ethical business conduct? You will find the information on IBM's website under Corporate responsibility, **http://www.ibm.com**.
6. Levi Strauss's unique corporate culture rewards and recognizes employee achievement. To learn about its employee community involvement program, go to the Levi Strauss website at **http://www.levistrauss.com**.
7. Want to see how the global environment is changing and learn the latest about global warming? Check out **http://www.climatehotmap.org**.
8. General Motors is committed to continuous improvement in its environmental performance. Check out GM's Sustainability Report at **http://www.gmsustainability.com**.
9. Before donating to any charity, check out its credentials and overall track record at **http://charitywatch.org**.
10. Learn how U.S. businesses gain competitive advantage through corporate social responsibility programs at the Business for Social Responsibility (BSR) website, **http://www.bsr.org**.

3 Competing in the Global Marketplace

Exhibit 3.1 (Credit: Xiquinho Silva /Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Introduction

Learning Outcomes

After reading this chapter, you should be able to answer these questions:

1. Why is global trade important to the United States, and how is it measured?
2. Why do nations trade?
3. What are the barriers to international trade?
4. How do governments and institutions foster world trade?
5. What are international economic communities?
6. How do companies enter the global marketplace?
7. What threats and opportunities exist in the global marketplace?
8. What are the advantages of multinational corporations?
9. What are the trends in the global marketplace?

EXPLORING BUSINESS CAREERS

Mike Schlater Domino's Pizza

Domino's Pizza has more than 14,000 stores worldwide. As executive vice president of Domino's Pizza's international division, Mike Schlater is president of Domino's Canada with more than 440 stores. Originally from Ohio, Schlater started his career with Domino's as a pizza delivery driver and worked his way up into management. Schlater saved his earnings, and with some help from his brother, he was able to accept the opportunity to have the first international Domino's franchise in Winnipeg, Manitoba, in

1983. Within weeks, Schlater's store in Canada reached higher sales than his previous store in Ohio had ever attained. However, it was not an easy start. Schlater had to identify the international suppliers and get them approved to sell their products to Domino's. This shows one of the challenges that organizations face when entering new global markets. To meet quality standards designed to protect a brand, companies must undertake an extensive review of potential new suppliers to ensure consistent product quality. By 2007, Schlater and a partner unified all of the franchises under one corporate umbrella, and Schlater is now president of Domino's of Canada, Ltd., which operates more than 440 stores located in every province, as well as the Yukon and Northwest Territories.

Exhibit 3.2 Domino's store. (Credit: Mr. Blue Mau Mau/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Such an impressive career path might seem like luck to some, but Schlater achieved his success due to determination and attention to detail. Luck did play a role in a recent event in his live, though. Schlater manages dough in his business but also came into "dough" by winning $250,000 in a lottery. Since Schlater believes in philanthropy, he donated the entire amount to Cardinal Carter High School in his hometown. Over the years, Schlater has donated millions of dollars to foundations and charities, such as The London Health Sciences Foundation, because he now has the ability to indulge after spending decades climbing the corporate ladder at Domino's Pizza. A father of three, he moved to Essex County from Winnipeg after buying the Domino's master franchise for Canada. He wanted to live close to the border because one of his daughters was in a private school in Ohio and another was headed to university there.

The master franchisees of Domino's Pizza's international business are individuals or entities who, under a specific licensing agreement with Domino's, control all operations within a specific country. They operate their own stores, set up a distribution infrastructure to transport materials into and throughout the country, and create subfranchisees. One particular benefit of master franchisees is their local knowledge. As discussed in this chapter, a major challenge when opening a business on foreign soil is negotiating the political, cultural, and economic differences of that country. Master franchisees allow Domino's, and the franchisee, to take advantage of their local expertise in dealing with marketing strategies, political and regulatory issues, and the local labor market. It takes local experience to know, for example, that only 30 percent of the people in Poland have phones, so carryout needs to be the focus of the business; that Turkey has changed its street names three times in the past 30 years, so delivery is much more challenging; or that, in Japanese, there is no word for pepperoni, the most popular topping worldwide. These are just a few of the challenges that Domino's has had to overcome on the road to becoming the worldwide leader in the pizza delivery business. Under the leadership of people like Schlater, and with the help of dedicated, local master franchisees, Domino's has been able to not only compete in but to lead the global pizza delivery market.

Sources: "Domino's Pizza Corporate Facts," http://phx.corporate-ir.net, accessed June 20, 2017; Domino's Canada website, https://www.dominos.ca, accessed June 20, 2017; Trevor Wilhelm, "Domino's CEO, who lives in Leamington, will donate $250K lotto winnings to high school," *Windsor Star*, February 27, 2015.

This chapter examines the business world of the global marketplace. It focuses on the processes of taking a business global, such as licensing agreements and franchisees; the challenges that are encountered; and the regulatory systems governing the world market of the 21st century.

Today, global revolutions are under way in many areas of our lives: management, politics, communications, and technology. The word *global* has assumed a new meaning, referring to a boundless mobility and competition in social, business, and intellectual arenas. The purpose of this chapter is to explain how global trade is conducted. We also discuss the barriers to international trade and the organizations that foster global trade. The chapter concludes with trends in the global marketplace.

3.1 Global Trade in the United States

1. Why is global trade important to the United States, and how is it measured?

No longer just an option, having a global vision has become a business imperative. Having a **global vision** means recognizing and reacting to international business opportunities, being aware of threats from foreign competitors in all markets, and effectively using international distribution networks to obtain raw materials and move finished products to the customer.

U.S. managers must develop a global vision if they are to recognize and react to international business opportunities, as well as remain competitive at home. Often a U.S. firm's toughest domestic competition comes from foreign companies. Moreover, a global vision enables a manager to understand that customer and distribution networks operate worldwide, blurring geographic and political barriers and making them increasingly irrelevant to business decisions. Over the past three decades, world trade has climbed from $200 billion a year to more than $1.4 trillion.[1] U.S. companies play a major role in this growth in world trade, with 113 of the Fortune 500 companies making over 50 percent of their profits outside the United States. Among these companies are recognizable names such as Apple, Microsoft, Pfizer, Exxon Mobil, and General Electric.[2]

Starbucks Corp. is among the fastest growing global consumer brands and one of the most visible emblems of U.S. commercial culture overseas. Of Starbucks's 24,000 total stores, almost 66 percent are international stores that contribute a substantial amount to the company's revenues, which have grown from $4.1 billion in 2003 to $21.3 billion in 2016.[3]

Go into a Paris McDonald's and you may not recognize where you are. There are no Golden Arches or utilitarian chairs and tables and other plastic features. The restaurants have exposed brick walls, hardwood floors, and armchairs. Some French McDonald's even have faux marble walls. Most restaurants have TVs with continuous music videos. You can even order an espresso, beer, and a chicken on focaccia bread sandwich. It's not America.

Global business is not a one-way street, where only U.S. companies sell their wares and services throughout the world. Foreign competition in the domestic market used to be relatively rare but now occurs in almost every industry. In fact, U.S. makers of electronic goods, cameras, automobiles, fine china, tractors, leather goods, and a host of other consumer and industrial products have struggled to maintain their domestic market shares against foreign competitors. Toyota now has 14 percent of the U.S. auto market, followed by Honda at 9 percent and Nissan with 8 percent.[4] Nevertheless, the global market has created vast new business opportunities for many U.S. firms.

The Importance of Global Business to the United States

Many countries depend more on international commerce than the United States does. For example, France, Great Britain, and Germany all derive more than 55 percent of their gross domestic product (GDP) from world trade, compared to about 28 percent for the United States.[5] Nevertheless, the impact of international business on the U.S. economy is still impressive:

- Trade-dependent jobs have grown at a rate three times the growth of U.S.-dependent jobs.
- Every U.S. state has realized a growth of jobs attributable to trade.
- Trade has an effect on both service and manufacturing jobs.[6]

These statistics might seem to imply that practically every business in the United States is selling its wares throughout the world, but most is accounted for by big business. About 85 percent of all U.S. exports of manufactured goods are shipped by 250 companies. Yet, 98 percent of all exporters are small and medium-size firms.[7]

The Impact of Terrorism on Global Trade

The terrorist attacks on America on September 11, 2001, and the Charlie Hebdo terrorist attacks in Paris in 2015 have changed the way the world conducts business. The immediate impacts of these events have included a short-term shrinkage of global trade. Globalization, however, will continue because the world's major markets are too vitally integrated for globalization to stop. Nevertheless, terrorism has caused the growth to be slower and costlier.[8]

Companies are paying more for insurance and to provide security for overseas staff and property. Heightened border inspections slow movements of cargo, forcing companies to stock more inventory. Tighter immigration policies curtail the liberal inflows of skilled and blue-collar workers that allowed companies to expand while keeping wages in check. The impact of terrorism may lessen over time, but multinational firms will always be on guard.[9]

Measuring Trade between Nations

International trade improves relationships with friends and allies; helps ease tensions among nations; and—economically speaking—bolsters economies, raises people's standard of living, provides jobs, and improves the quality of life. The value of international trade is over $16 trillion a year and growing. This section takes a look at some key measures of international trade: exports and imports, the balance of trade, the balance of payments, and exchange rates.

Exports and Imports

The developed nations (those with mature communication, financial, educational, and distribution systems) are the major players in international trade. They account for about 70 percent of the world's exports and imports. **Exports** are goods and services made in one country and sold to others. **Imports** are goods and services that are bought from other countries. The United States is both the largest exporter and the largest importer in the world.

Each year the United States exports more food, animal feed, and beverages than the year before. A third of U.S. farm acreage is devoted to crops for export. The United States is also a major exporter of engineering products and other high-tech goods, such as computers and telecommunications equipment. For more than 60,000 U.S. companies (the majority of them small), international trade offers exciting and profitable opportunities. Among the largest U.S. exporters are Apple, General Motors Corp., Ford Motor Co., Procter & Gamble, and Cisco Systems.[10]

Despite our impressive list of resources and great variety of products, imports to the United States are also growing. Some of these imports are raw materials that we lack, such as manganese, cobalt, and bauxite, which are used to make airplane parts, exotic metals, and military hardware. More modern factories and lower labor costs in other countries make it cheaper to import industrial supplies (such as steel) and production equipment than to produce them at home. Most of Americans' favorite hot beverages—coffee, tea, and cocoa—are imported. Lower manufacturing costs have resulted in huge increases in imports from China.

Balance of Trade

The difference between the value of a country's exports and the value of its imports during a specific time is the country's **balance of trade**. A country that exports more than it imports is said to have a *favorable* balance of trade, called a **trade surplus**. A country that imports more than it exports is said to have an *unfavorable* balance of trade, or a **trade deficit**. When imports exceed exports, more money from trade flows out of the country than flows into it.

Although U.S. exports have been booming, we still import more than we export. We have had an unfavorable balance of trade throughout the 1990s, 2000s and 2010s. In 2016, our exports totaled $2.2 trillion, yet our imports were $2.7 trillion. Thus, in 2016 the United States had a trade deficit of $500 billion.[11] America's exports continue to grow, but not as fast as our imports: The export of goods, such as computers, trucks, and airplanes, is very strong. The sector that is lagging in significant growth is the export of services. Although America exports many services—ranging from airline trips to education of foreign students to legal advice—part of the problem is due to piracy, which leads companies to restrict the distribution of their services to certain regions. The FBI estimates that the theft of intellectual property from products, books and movies, and pharmaceuticals totals in the billions every year.[12]

Balance of Payments

Another measure of international trade is called the **balance of payments**, which is a summary of a country's international financial transactions showing the difference between the country's total payments to and its total receipts from other countries. The balance of payments includes imports and exports (balance of trade), long-term investments in overseas plants and equipment, government loans to and from other countries, gifts and foreign aid, military expenditures made in other countries, and money transfers in and out of foreign banks.

From 1900 until 1970, the United States had a trade surplus, but in the other areas that make up the balance of payments, U.S. payments exceeded receipts, largely due to the large U.S. military presence abroad. Hence, almost every year since 1950, the United States has had an unfavorable balance of payments. And since 1970, both the balance of payments *and* the balance of trade have been unfavorable. What can a nation do to reduce an unfavorable balance of payments? It can foster exports, reduce its dependence on imports, decrease its military presence abroad, or reduce foreign investment. The U.S. balance of payments deficit was over $504 billion in 2016.[13]

The Changing Value of Currencies

The exchange rate is the price of one country's currency in terms of another country's currency. If a country's currency *appreciates*, less of that country's currency is needed to buy another country's currency. If a country's currency *depreciates*, more of that currency will be needed to buy another country's currency.

How do appreciation and depreciation affect the prices of a country's goods? If, say, the U.S. dollar depreciates relative to the Japanese yen, U.S. residents have to pay more dollars to buy Japanese goods. To illustrate, suppose the dollar price of a yen is $0.012 and that a Toyota is priced at 2 million yen. At this exchange rate, a U.S. resident pays $24,000 for a Toyota ($0.012 × 2 million yen = $24,000). If the dollar depreciates to $0.018 to one yen, then the U.S. resident will have to pay $36,000 for a Toyota.

As the dollar depreciates, the prices of Japanese goods rise for U.S. residents, so they buy fewer Japanese goods—thus, U.S. imports decline. At the same time, as the dollar depreciates relative to the yen, the yen appreciates relative to the dollar. This means prices of U.S. goods fall for the Japanese, so they buy more U.S. goods—and U.S. exports rise.

Currency markets operate under a system called **floating exchange rates**. Prices of currencies "float" up and down based upon the demand for and supply of each currency. Global currency traders create the supply of and demand for a particular currency based on that currency's investment, trade potential, and economic strength. If a country decides that its currency is not properly valued in international currency markets, the government may step in and adjust the currency's value. In a **devaluation**, a nation lowers the value of its currency relative to other currencies. This makes that country's exports cheaper and should, in turn, help the balance of payments.

In other cases, a country's currency may be undervalued, giving its exports an unfair competitive advantage. Many people believe that China's huge trade surplus with the United States is partially because China's currency was undervalued. In 2017, the U.S. Department of Commerce issued a fact sheet detailing how it accused China of dumping steel on the U.S. market as well as providing financial assistance to Chinese companies to produce, manufacture, and export stainless steel to the United States from the People's Republic of China.[14]

CONCEPT CHECK

1. What is global vision, and why is it important?

2. What impact does international trade have on the U.S. economy?
3. Explain the impact of a currency devaluation.

3.2 Why Nations Trade

2. Why do nations trade?

One might argue that the best way to protect workers and the domestic economy is to stop trade with other nations. Then the whole circular flow of inputs and outputs would stay within our borders. But if we decided to do that, how would we get resources like cobalt and coffee beans? The United States simply can't produce some things, and it can't manufacture some products, such as steel and most clothing, at the low costs we're used to. The fact is that nations—like people—are good at producing different things: you may be better at balancing a ledger than repairing a car. In that case you benefit by "exporting" your bookkeeping services and "importing" the car repairs you need from a good mechanic. Economists refer to specialization like this as *advantage.*

Absolute Advantage

A country has an **absolute advantage** when it can produce and sell a product at a lower cost than any other country or when it is the only country that can provide a product. The United States, for example, has an absolute advantage in reusable spacecraft and other high-tech items.

Suppose that the United States has an absolute advantage in air traffic control systems for busy airports and that Brazil has an absolute advantage in coffee. The United States does not have the proper climate for growing coffee, and Brazil lacks the technology to develop air traffic control systems. Both countries would gain by exchanging air traffic control systems for coffee.

Comparative Advantage

Even if the United States had an absolute advantage in both coffee and air traffic control systems, it should still specialize and engage in trade. Why? The reason is the **principle of comparative advantage**, which says that each country should specialize in the products that it can produce most readily and cheaply and trade those products for goods that foreign countries can produce most readily and cheaply. This specialization ensures greater product availability and lower prices.

For example, India and Vietnam have a comparative advantage in producing clothing because of lower labor costs. Japan has long held a comparative advantage in consumer electronics because of technological expertise. The United States has an advantage in computer software, airplanes, some agricultural products, heavy machinery, and jet engines.

Thus, comparative advantage acts as a stimulus to trade. When nations allow their citizens to trade whatever goods and services they choose without government regulation, free trade exists. **Free trade** is the policy of permitting the people and businesses of a country to buy and sell where they please without restrictions. The opposite of free trade is **protectionism**, in which a nation protects its home industries from outside competition by establishing artificial barriers such as tariffs and quotas. In the next section, we'll look at the various barriers, some natural and some created by governments, that restrict free trade.

The Fear of Trade and Globalization

The continued protests during meetings of the World Trade Organization and the protests during the convocations of the World Bank and the International Monetary Fund (the three organizations are discussed later in the chapter) show that many people fear world trade and globalization. What do they fear? The negatives of global trade are as follows:

- Millions of Americans have lost jobs due to imports or production shifting abroad. Most find new jobs, but often those jobs pay less.
- Millions of others fear losing their jobs, especially at those companies operating under competitive pressure.
- Employers often threaten to export jobs if workers do not accept pay cuts.
- Service and white-collar jobs are increasingly vulnerable to operations moving offshore.

Sending domestic jobs to another country is called **outsourcing**, a topic you can explore in more depth. Many U.S. companies, such as Dell, IBM, and AT&T, have set up call service centers in India, the Philippines, and other countries. Now even engineering and research and development jobs are being outsourced. Outsourcing and "American jobs" were a big part of the 2016 presidential election with Carrier's plan to close a plant in Indianapolis and open a new plant in Mexico. While intervention by President Trump did lead to 800 jobs remaining in Indianapolis, Carrier informed the state of Indiana that it will cut 632 workers from its Indianapolis factory. The manufacturing jobs will move to Monterrey, Mexico, where the minimum wage is $3.90 per day.[15]

Exhibit 3.3 Anti-globalization groups oppose America's free-trade stance, arguing that corporate interests are hurting the U.S. economy and usurping the power of the American people. The recent protests at the G20 meetings in Hamburg, Germany, expressed anti-free-trade sentiment, supporting the idea that multinational corporations wield too much power. *Are fears expressed by anti-globalization activists and nationalists justified?* (Credit: fiction of reality/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

So is outsourcing good or bad? If you happen to lose your job, it's obviously bad for you. However, some economists say it leads to cheaper goods and services for U.S. consumers because costs are lower. Also, it should stimulate exports to fast-growing countries. No one knows how many jobs will be lost to outsourcing in coming years. According to estimates, almost 2.4 million U.S. jobs were outsourced in 2015.[16]

Benefits of Globalization

A closer look reveals that globalization has been the engine that creates jobs and wealth. Benefits of global trade include the following:

- Productivity grows more quickly when countries produce goods and services in which they have a comparative advantage. Living standards can increase faster. One problem is that big **G20** countries have added more than 1,200 restrictive export and import measures since 2008.
- Global competition and cheap imports keep prices down, so inflation is less likely to stop economic growth. However, in some cases this is not working because countries manipulate their currency to get a price advantage.
- An open economy spurs innovation with fresh ideas from abroad.
- Through infusion of foreign capital and technology, global trade provides poor countries with the chance to develop economically by spreading prosperity.
- More information is shared between two trading partners that may not have much in common initially, including insight into local cultures and customs, which may help the two nations expand their collective knowledge and learn ways to compete globally.[17]

CONCEPT CHECK

1. Describe the policy of free trade and its relationship to comparative advantage.
2. Why do people fear globalization?
3. What are the benefits of globalization?

3.3 Barriers to Trade

3. What are the barriers to international trade?

International trade is carried out by both businesses and governments—as long as no one puts up trade barriers. In general, trade barriers keep firms from selling to one another in foreign markets. The major obstacles to international trade are natural barriers, tariff barriers, and nontariff barriers.

Natural Barriers

Natural barriers to trade can be either physical or cultural. For instance, even though raising beef in the relative warmth of Argentina may cost less than raising beef in the bitter cold of Siberia, the cost of shipping the beef from South America to Siberia might drive the price too high. *Distance* is thus one of the natural barriers to international trade.

Language is another natural trade barrier. People who can't communicate effectively may not be able to