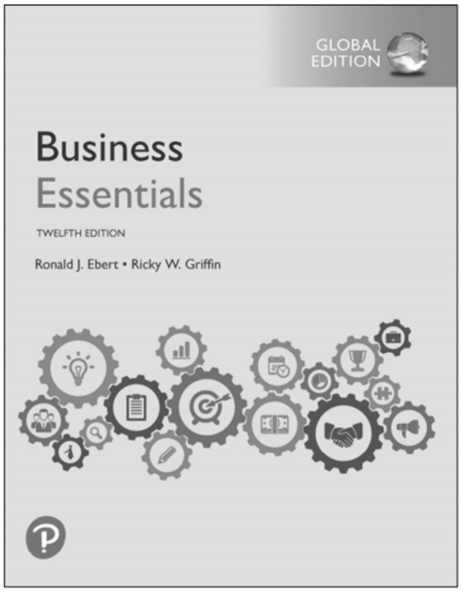
Business Essentials

Twelfth Edition, Global Edition



Chapter 1

The Global Business Environment

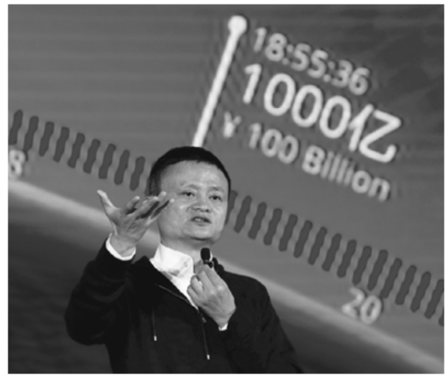
Pearson

If this PowerPoint presentation contains mathematical equations, you may need to check that your computer has the following installed:

1) MathType Plugin
2) Math Player (free versions available)
3) NVDA Reader (free versions available)

Introduction

- China has moved away from a socialist towards a free market economy termed “socialist market economy.”
- Alibaba accounts for 80% of China’s online shopping.
  - China population 1.4 billion
  - US population <3 million



Alibaba owner Jack Ma

Pearson

China calls itself a “socialist market economy.” This relatively new version of China allows individuals to own property and to take risks, as Jack Ma did when he started Alibaba.

In 2016 Alibaba accounted for 80 percent of China’s online shopping and total sales dwarfed other e-commerce companies like Amazon and eBay.

China is a giant, growing market. In 2015, General Motors sold 3.6 million cars in China and 3 million in the United States, with Buicks and Cadillacs leading the charge. China’s population is now almost 1.4 billion (roughly 18.5 percent of the world population). Compare that to a population in the United States of less than 330 million in about the same land area.

Learning Objectives (1 of 2)

1. **Define** the nature of global business, describe the external environments of business, and discuss how these environments affect the success or failure of organizations.
2. **Describe** the different types of global economic systems according to the means by which they control the factors of production.

Learning Objectives (2 of 2)

3. **Show** how markets, demand, and supply affect resource distribution in the global market, identify the elements of private enterprise, and explain the various degrees of competition in the global economic system.
4. **Explain** the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.

The Concept of Business and Profit

- **Business**
  - organization that provides goods or services to earn profits
- **Profits**
  - difference between a business's revenues and its expenses

Pearson

Businesses produce most of the goods and services we consume.
They employ most working people.
They create most new innovations and provide a vast range of opportunities for new businesses.
Many businesses support charities and provide community leadership.

The External Environment of Business

- **External Environment**
  - everything outside an organization’s boundaries that might affect it

Pearson

All businesses regardless of their size, location, or mission operate within a larger external environment. This external environment consists of everything outside an organization’s boundaries that might affect it. (Businesses also have an internal environment, more commonly called corporate culture; we discuss this in Chapter 5.)

Not surprisingly, the external environment plays a major role in determining the success or failure of any organization. Managers must, therefore, have a complete and accurate understanding of their environment and then strive to operate and compete within it. Businesses can also influence their environments.

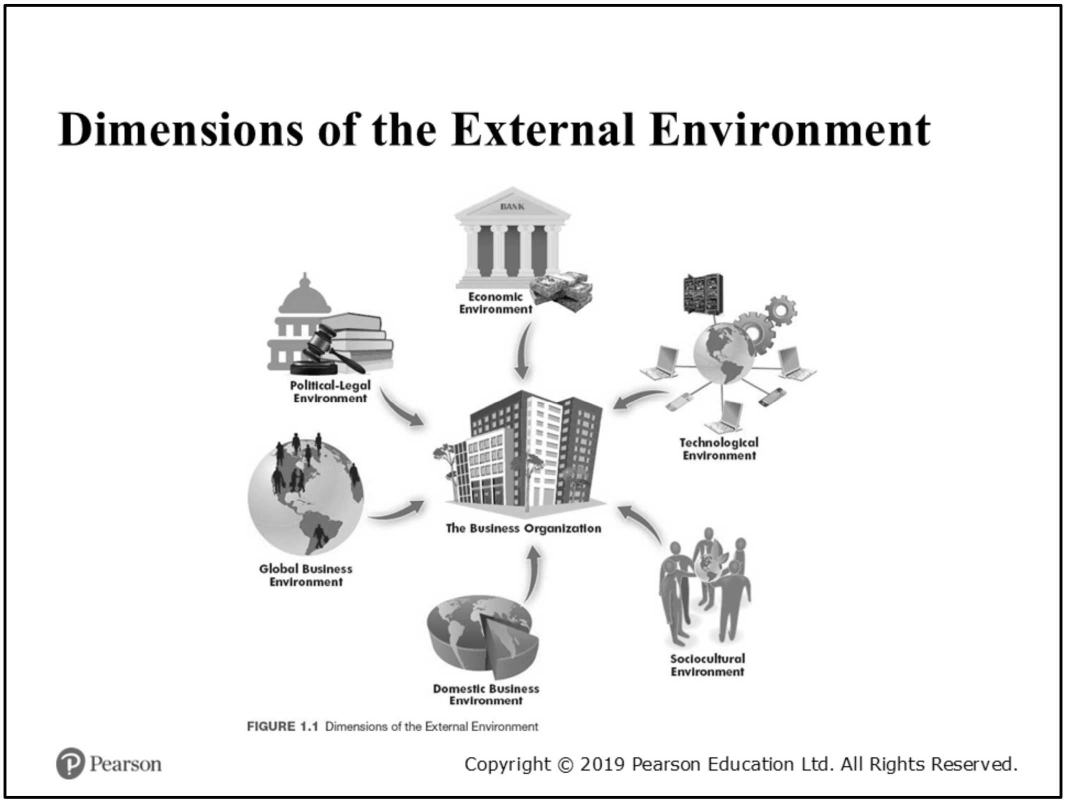


Figure 1.1 shows the major dimensions and elements of the external environment as it affects businesses today. These include the domestic business environment, the global business environment, the technological environment, the political-legal environment, the socio cultural environment, and the economic environment.

The **Domestic Business Environment** is the environment in which a firm conducts its operations and derives its revenues.
The **Global Business Environment** encompasses the international forces that affect a business and includes international trade agreements, international economic conditions, and political unrest.
The **Technological Environment** encompasses all the ways by which firms create value for their constituents and includes human knowledge, work methods, physical equipment, electronics, and telecommunications.
The **Political-Legal Environment** is the relationship between business and government.
The **Sociocultural Environment** includes the customs, mores, values, and demographic characteristics of the society in which an organization functions and determines the goods and services, as well as the standards of business conduct, that a society is likely to value and accept.
The **Economic Environment** includes relevant conditions that exist in the economic system in which a company operates.

The External Environments of Business (1 of 2)

- **Domestic Business Environment -** the environment in which a firm conducts operations and derives revenues
- **Global Business Environment -** international forces that affect a business and includes international trade agreements, international economic conditions, and political unrest
- **Technological Environment -** ways by which firms create value for their constituent

Pearson

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The External Environments of Business (2 of 2)

- **Political-Legal Environment -** the relationship between business and government
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- **The Economic Environment -** includes relevant conditions that exist in the economic system in which a company operates

Pearson

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The **Economic Environment** includes relevant conditions that exist in the economic system in which a company operates.

Economic Systems

- **Economic system**
  - a nation's system for allocating its resources among its citizens, both individuals and organizations

Pearson

An economic system is a nation's system for allocating its resources among its citizens, both individuals and organizations.

Factors of Production (1 of 2)

- **Labor** includes the physical and intellectual contributions people make while engaged in economic production and is also called human resources.
- **Capital** is the term used to describe the financial resources needed to operate a business.
- An **Entrepreneur** is a person who accepts the risks and opportunities entailed in creating and operating a new business venture.

Pearson

A basic difference between economic systems is the way in which a system manages its factors of production, the resources that a country's businesses use to produce goods and services.

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Capital is the term used to describe the financial resources needed to operate a business.

An **Entrepreneur** is a person who accepts the risks and opportunities entailed in creating and operating a new business venture.

Factors of Production (2 of 2)

- **Physical resources -** tangible things that organizations use to conduct their business and include natural resources and raw materials
- **Information resources -** data and other information used by businesses and include market forecasts, the specialized knowledge of people, and economic data

Pearson

Physical resources are tangible things that organizations use to conduct their business and include natural resources and raw materials, offices, storage and production facilities, parts and supplies, computers, and peripherals.

Information resources are data and other information used by businesses and include market forecasts, the specialized knowledge of people, and economic data.

Types of Economic Systems (1 of 3)

- **Planned Economy**
  - economy that relies on a centralized government to control all or most factors of production and to make all or most production and allocation decisions
  - Communism, socialism

Pearson

In market economies, the ownership of both the factors of production and businesses themselves is private. That is, ownership is held by entrepreneurs, individual investors, and other businesses.

In planned economies, the factors of production and all businesses are owned or controlled by the government.

In reality, most systems fall between these extremes.

Communism is a system in which the government owns and operates all factors of production.

With **socialism**, the government owns and operates selected major industries.

Types of Economic Systems (2 of 3)

- **Market economy**
  - individual producers and consumers control production and allocation by creating combinations of supply and demand

Pearson

A **market** is a mechanism for exchange between the buyers and sellers of a particular good or service. Market economies rely on capitalism and free enterprise to create an environment in which producers and consumers are free to sell and buy what they choose.

Types of Economic Systems (3 of 3)

- **Mixed market economy**
  - features characteristics of both planned and market economies
- **Privatization**
  - process of converting government enterprises into privately owned companies

Geoff A Howard/Alamy Stock Photo

The People's Republic of China is moving towards a mixed market economy

Pearson

In reality, most countries rely on some form of mixed market economy that features characteristics of both planned and market economies.

Even the U.S. economy restricts certain activities. Some products can't be sold legally, others can be sold only to people of a certain age, advertising must be truthful, and so forth.

When a government is making a change from a planned economy to a market economy, it usually begins to adopt market mechanisms through privatization, the process of converting government enterprises into privately owned companies. In recent years, this practice has spread to many other countries as well. For example, the postal system in many countries is government owned and government managed.

Demand and Supply in a Market Economy

- **Demand**
  - the willingness and ability of buyers to purchase a product (a good or a service)
- **Supply**
  - the willingness and ability of producers to offer a good or service for sale

Pearson

The law of demand: Buyers will purchase (demand) *more* of a product as its price *drops* and *less* of a product as its price *increases*.

The law of supply: Producers will offer (supply) *more* of a product for sale as its price *rises* and *less* of a product as its price *drops*.

A **Demand and Supply Schedule** is an assessment of the relationships among different levels of demand and supply at different price levels.

Demand and Supply (1 of 2)

DEMAND AND SUPPLY SCHEDULES

Price	Quantity of Pizzas Demanded	Quantity of Pizzas Supplied
$2	2,000	100
$4	1,900	400
$6	1,600	600
$8	1,200	800
$10	1,000	1,000
$12	800	1,200
$14	600	1,300
$16	400	1,600
$18	200	1,800
$20	100	2,000

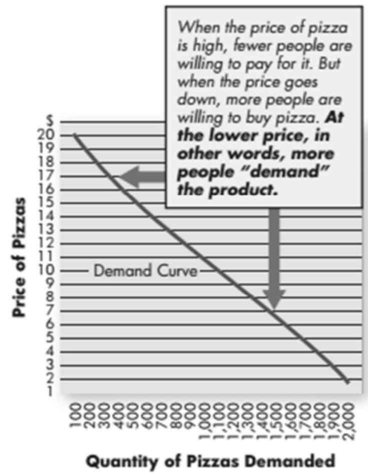


Figure 1.2 shows demand and supply curves for pizzas. Demand increases as price decreases; supply increases as price increases.

When demand and supply curves are plotted on the same graph, the point at which they intersect is the market price (also called the equilibrium price)—the price at which the quantity of goods demanded and the quantity of goods supplied are equal.

The equilibrium price for pizzas in our example is $10. At this point, the quantity of pizzas demanded and the quantity of pizzas supplied are the same: 1,000 pizzas per week.

A **Demand Curve** is a graph showing how many units of a product will be demanded (bought) at different prices.

A **Supply Curve** is a graph showing how many units of a product will be supplied (offered for sale) at different prices.

Demand and Supply (2 of 2)

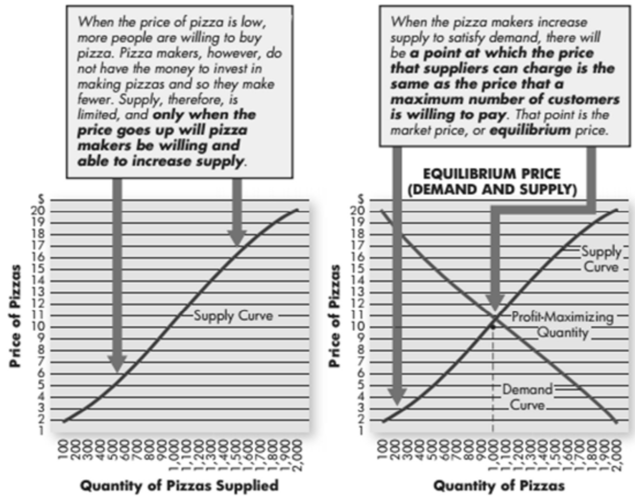


FIGURE 1.2 Demand and Supply

The Market Price (or Equilibrium Price) is the profit-maximizing price at which the quantity of goods demanded and the quantity of goods supplied are equal. Surplus is a situation in which quantity supplied exceeds quantity demanded. A shortage is a situation in which quantity demanded exceeds quantity supplied.

Private Enterprise and Competition in a Market Economy (1 of 3)

- **Private property rights**
  - one that allows individuals to pursue their own interests with minimal government restriction
  - private property rights, freedom of choice, profits, and competition

Pearson

Market economies rely on a private enterprise system—one that allows individuals to pursue their own interests with minimal government restriction. In turn, private enterprise requires the presence of four elements: private property rights, freedom of choice, profits, and competition.

Private Enterprise and Competition in a Market Economy (2 of 3)

1. **Private enterprise system**
   - ownership of the resources used to create wealth is in the hands of individuals
2. **Freedom of choice**
   - you can sell your labor to any employer you choose

Private Enterprise and Competition in a Market Economy (3 of 3)

3. **Profits**
   – the lure of profits leads some people to abandon the security of working for someone else and assume the risks of entrepreneurship
4. **Competition**
   – occurs when two or more businesses vie for the same resources or customers

Pearson

Degrees of Competition (1 of 5)

Table 1.1 Degrees of Competition

Characteristic	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Example	Local farmer	Stationery store	Steel industry	Public utility
Number of competitors	Many	Many, but fewer than in perfect competition	Few	None
Ease of entry into industry	Relatively easy	Fairly easy	Difficult	Regulated by government
Similarity of goods or services offered by competing firms	Identical	Similar	Can be similar or different	No directly competing goods or services
Level of control over price by individual firms	None	Some	Some	Considerable

Pearson

Degrees of Competition (2 of 5)

For **perfect competition** to exist, two conditions must prevail:

1. all firms in an industry must be small, and
2. the number of firms in the industry must be large

Pearson

For perfect competition to exist, two conditions must prevail:
(1) all firms in an industry must be small
(2) the number of firms in the industry must be large

Under these conditions, no single firm is powerful enough to influence the price of its product. Prices are, therefore, determined by such market forces as supply and demand.

In addition, these two conditions also reflect four principles:

1. The products of each firm are so similar that buyers view them as identical to those of other firms.
2. Both buyers and sellers know the prices that others are paying and receiving in the marketplace.
3. Because each firm is small, it is easy for firms to enter or leave the market.
4. Going prices are set exclusively by supply and demand and accepted by both sellers and buyers.

Degrees of Competition (3 of 5)

- **Monopolistic Competition**
  - market or industry characterized by numerous buyers and relatively numerous sellers trying to differentiate their products from those of competitors

Pearson

In monopolistic competition, there are numerous sellers trying to make their products at least seem to be different from those of competitors.

Although there are many sellers involved in a monopolistic competition, they tend to be fewer than in pure competition.

Differentiating strategies include brand names, design or styling, and advertising.

Degrees of Competition (4 of 5)

- **Oligopoly**
  - market or industry characterized by a handful of (generally large) sellers with the power to influence the prices of their products

When an industry has only a handful of sellers, an oligopoly exists.

As a general rule, these sellers are quite large.

The entry of new competitors is hard because large capital investment is needed.

Degrees of Competition (5 of 5)

- **Monopoly**
  - market or industry in which there is only one producer that can therefore set the prices of its products
- **Natural Monopoly**
  - industry in which one company can most efficiently supply all needed goods or services

A monopoly exists when an industry or market has only one producer (or else is so dominated by one producer that other firms cannot compete with it).

A sole supplier enjoys complete control over the prices of its products. Its only constraint is a decrease in consumer demand as a result of increased prices.

In the United States, laws, such as the Sherman Antitrust Act (1890) and the Clayton Act (1914), forbid many monopolies and regulate prices charged by natural monopolies - industries in which one company can most efficiently supply all needed goods or services. Many electric companies are natural monopolies because they can supply all the power needed in a local area. Duplicate facilities—such as two power plants and two sets of power lines—would be wasteful.

Economic Indicators

- **Economic indicators**
  - statistics that show whether an economic system is strengthening, weakening, or remaining stable
  - help assess the performance of an economy

Pearson

The performance of a country's economic system varies over time.

Sometimes it gains strength and brings new prosperity to its members (this describes the U.S. economy during the early years of the twenty-first century); other times it weakens and damages their fortunes (as was the case in the years 2009–2010). Clearly then, knowing how an economy is performing is useful for both, business owners and investors alike.

Economic Growth, Aggregate Output, and Standard of Living (1 of 2)

- **Business cycle**
  - the pattern of short-term ups and downs (or expansions and contractions) in an economy
- **Aggregate output**
  - the total quantity of goods and services produced by an economic system during a given period
  - primary measure of growth in the business cycle

Experts call the pattern of short-term ups and downs (or, better, expansions and contractions) in an economy the business cycle. The primary measure of growth in the business cycle is aggregate output or the total quantity of goods and services produced by an economic system during a given period.

Economic Growth, Aggregate Output, and Standard of Living (2 of 2)

- **Standard of living**
  - the total quantity and quality of goods and services that they can purchase with the currency used in their economic system

To put it simply, an increase in aggregate output is growth (or economic growth). When output grows more quickly than the population, two things usually follow:

- Output per capita—the quantity of goods and services per person—goes up.
- The system provides more of the goods and services that people want.

When these two things occur, people living in an economic system benefit from a higher standard of living, which refers to the total quantity and quality of goods and services that they can purchase with the currency used in their economic system.

Gross Domestic Product (1 of 3)

- **Gross domestic product (GDP)**
  - refers to the total value of all goods and services produced within a given period by a national economy through domestic factors of production
  - measure of aggregate output

Gross domestic product (GDP) refers to the total value of all goods and services produced within a given period by a national economy through domestic factors of production.

GDP is a measure of the aggregate output. Generally speaking, if the GDP is going up, aggregate output is going up; or in other words, if the aggregate output is going up, the nation is experiencing economic growth.

Gross Domestic Product (2 of 3)

Table 1.2 U.S. GDP and GDP per Capita

2015 GDP ($ Trillion)	2015 GDP: Real Growth Rate (%)	2015 GDP per Capita: Purchasing Power Parity
$17.95	2.4%	$55,800

GDP (gross domestic product)

Gross National Product

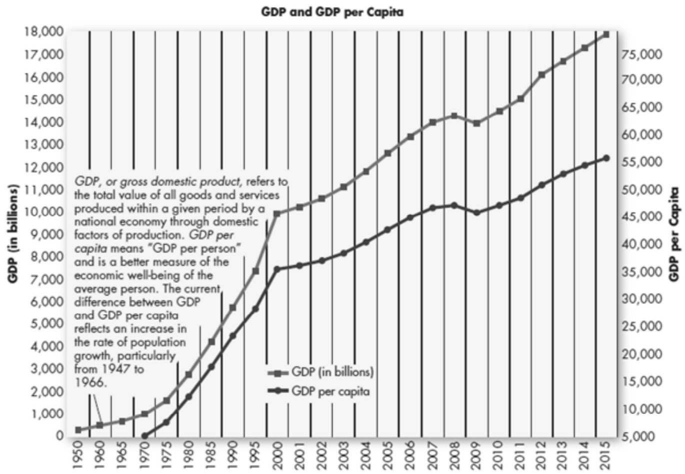
- **Gross national product (GNP)**
  - refers to the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located

Pearson

Sometimes, economists also use the term gross national product (GNP), which refers to the total value of all goods and services produced by a national economy within a given period of time, regardless of where the factors of production are located.

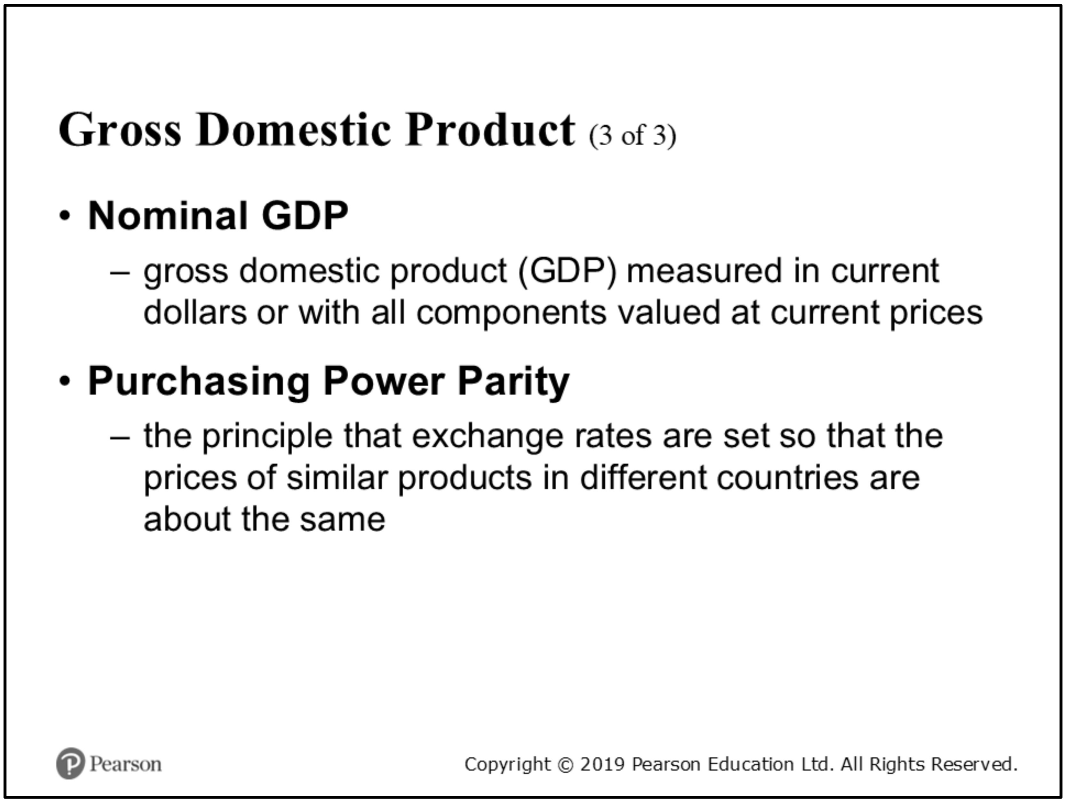
What, precisely, is the difference between GDP and GNP?
Consider a General Motors automobile plant in Brazil. The profits earned by the factory are included in U.S. GNP—but not in GDP—because its output is not produced domestically (that is, in the United States). Conversely, those profits are included in Brazil's GDP—but not GNP—because they are produced domestically (that is, in Brazil).

GDP and GDP per Capita



Note: This graph is shown in five-year increments until the year 2000, after which it is shown in one-year increments so as to provide more detail for recent periods. Hence, the curve artificially "flattens" after 2000.

FIGURE 1.3 GDP and GDP per Capita



We calculate real GDP when we adjust GDP to account for changes in currency values and price changes.

When we make this adjustment, we account for both GDP and purchasing power parity, or the principle that exchange rates are set so that the prices of similar products in different countries are about the same. Purchasing power parity gives us a much better idea of what people can actually buy with the financial resources allocated to them by their respective economic systems.

World Prices of a Big Mac

FIGURE 1.4 Price of a Big Mac in U.S. Currency in July 2015

Productivity (1 of 2)

- **Productivity**
  - measure of economic growth that compares how much a system produces with the resources needed to produce it

Pearson

A major factor in the growth of an economic system is productivity, which is a measure of economic growth that compares how much a system produces with the resources needed to produce it.

Let's say that it takes 1 U.S. worker and 1 U.S. dollar to make 10 soccer balls in an 8-hour workday. Let's also say that it takes 1.2 Saudi workers and the equivalent of 1.5 dollars in Riyals, the currency of Saudi Arabia, to make 10 soccer balls in the same 8-hour workday. We can say that the U.S. soccer-ball industry is more productive than the Saudi soccer-ball industry. The two factors of production in this extremely simple case are labor and capital.

Productivity (2 of 2)

- **Balance of trade**
  - the economic value of all the products that a country exports minus the economic value of its imported products
  - Positive or negative balance
- **National Debt**
  - the amount of money the government owes its creditors

Pearson

A *positive* balance of trade results when a country exports (sells to other countries) more than it imports (buys from other countries).

A *negative* balance of trade results when a country imports more than it exports.

The Balance of Trade

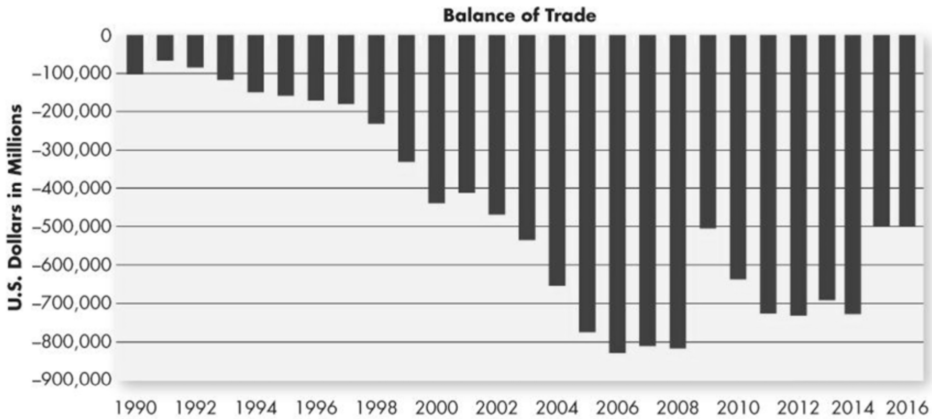


FIGURE 1.5 Balance of Trade

Economic Stability (1 of 2)

- **Stability**
  - condition in which the amount of money available in an economic system and the quantity of goods and services produced in it are growing at about the same rate
- **Inflation**
  - occurs when widespread price increases occur throughout an economic system

Pearson

Stability is a condition in which the amount of money available in an economic system and the quantity of goods and services produced in it are growing at about the same rate. A chief goal of an economic system, stability can be threatened by certain factors.

Inflation occurs when an economic system experiences widespread price increases. Instability results when the amount of money injected into an economy exceeds the increase in actual output, so people have more money to spend but the same quantity of products available to buy. As supply and demand principles tell us, as people compete with one another to buy available products, prices go up.

High prices will eventually bring the amount of money in the economy back down. However, these processes are imperfect—the additional money will not be distributed proportionately to all people, and price increases often continue beyond what is really necessary. As a result, purchasing power for many people declines.

Economic Stability (2 of 2)

- **Unemployment**
  - the level of joblessness among people actively seeking work in an economic system
- **Recession**
  - a period during which aggregate output, as measured by GDP, declines
- **Depression**
  - a prolonged and deep recession

Pearson

Unemployment is the level of joblessness among people actively seeking work in an economic system. When unemployment is low, there is a shortage of labor available for businesses to hire. As businesses compete with one another for the available supply of labor, they raise the wages they are willing to pay. Then, because higher labor costs eat into profit margins, they raise the prices of their products. Although consumers have more money to inject into the economy, this increase is soon undone by higher prices, so purchasing power declines.

During a recession, producers need fewer employees—less labor—to produce products. Unemployment, therefore, goes up. A recession is more precisely defined as a period during which aggregate output, as measured by real GDP, declines.

A prolonged and deep recession is called a depression. The last major depression in the United States started in 1929 and lasted more than 10 years. Most economists believe that the 2008–2011 recession, although the worst in decades, was not really a depression.

Managing the U.S. Economy (1 of 2)

- **Fiscal Policies**
  - policies used by a government regarding how it collects and spends revenue
- **Monetary Policies**
  - policies used by a government to control the size of its money supply

Pearson

The government manages the collection and spending of its revenues through fiscal policies. Tax rates, for example, can play an important role in fiscal policies helping to manage the economy.

Monetary policies focus on controlling the size of the nation's money supply. Working primarily through the Federal Reserve System (the nation's central bank, often referred to simply as "the Fed"), the government can influence the ability and willingness of banks throughout the country to lend money.

Managing the U.S. Economy (2 of 2)

- **Stabilization Policy**
  - government economic policy intended to smooth out fluctuations in output and unemployment and to stabilize prices

Pearson

Taken together, fiscal policy and monetary policy make up the stabilization policy, defined as the government economic policy in which the goal is to smooth out fluctuations in output and unemployment and to stabilize prices. In effect, the economic recession that started in 2008 was a significant departure from stabilization as business valuations dropped and jobs were eliminated. The various government interventions, such as financial bailouts, represented strategies to restore economic stability.

Applying What You’ve Learned (1 of 2)

1. Define the nature of global business, describe the external environments of business, and discuss how these environments affect the success or failure of organizations.
2. Describe the different types of global economic systems according to the means by which they control the factors of production.

Applying What You've Learned (2 of 2)

3. Show how markets, demand, and supply affect resource distribution in the global market, identify the elements of private enterprise, and explain the various degrees of competition in the global economic system.
4. Explain the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.

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