

GLOBAL
EDITION 



Business Essentials

Thirteenth Edition

Ronald J. Ebert • Ricky W. Griffin



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business essentials

**THIRTEENTH EDITION
GLOBAL EDITION**

Ronald J. Ebert

Ricky W. Griffin



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For Sutton, who may one day be in charge of everything!
—R. W. G.

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preface

Wearing the Hats

There's an old adage about people wearing different "hats." This usually means that people have different roles to play in different settings. For example, your roles may include student, child, spouse, partner, employee, friend, and/or parent. Each of these roles needs a different hat—when you play the role of a student, for example, you wear one hat, but when you go to your part-time job, you put on a different hat. From the perspective of business, there are a variety of different hats that you might wear:

- **The Employee Hat.** One hat is as an employee working for a business. Many people wear this hat during the early stages of their career. To wear the hat successfully, you will need to understand your place in the organization—your job, how to work with others, and so on. You'll begin to see how to best wear this hat as you study organizing business enterprises in Chapter 6 and how organizations manage people in Chapter 10, as well as in several other places in this book.
- **The Employer or Boss Hat.** It is also likely that one day other people will be working for you. You'll still have your own job responsibilities, of course. But you'll now also need to know how to manage other people—how to understand, lead, and motivate them and the social and legal parameters that affect how you deal with them. Chapters 3, 5, 8, and 9 provide information about how you can best wear this hat, although the manager's hat runs throughout the entire book.
- **The Consumer Hat.** Even if you don't work for a business, you will still wear the hat of a consumer. Whenever you fill your car at Shell, buy an airline ticket from Delta and charge it on Visa, order a new backpack from Amazon, buy clothes at H&M, or stream a movie on Netflix, you're consuming products created by business. To wear this hat effectively, you need to know how to assess the value of what you're buying, your rights as a consumer, and so on. We discuss how you can best wear this hat in Chapters 4, 7, 11, 12, and 13.
- **The Investor Hat.** The final business hat is that of an investor. You may buy a business or work for a company that lets you buy its stock. You may also invest in companies by buying their stock or shares of a mutual fund. For you to invest wisely, you must understand some basics, such as financial markets, business earnings, and the costs of investment. Chapters 4, 15, 16, 17, and Appendix III will help you learn how to best wear this hat.

Many people wear more than one of these hats at the same time. Regardless of how many hats you wear or when you may be putting them on, it should be clear that you have in the past, do now, and will in the future interface with many businesses in different ways. Knowing how to best wear all these hats is what this book is all about.

New to This Edition

Chapter Updates

All facts, figures, and examples have been updated throughout the book to reflect the most current information available. Similarly, all of the end-of-chapter material has been revised and updated. Integrated coverage of the 2020 COVID-19 pandemic and resulting economic fallout has also been integrated throughout the book. Detailed chapter-by-chapter updates are summarized below.

Chapter 1

- New Opening Case about Lidl Stiftung & Co. KG
- New Entrepreneurship and New Ventures box about luxury items on a budget
- Finding a Better Way box updated
- All economic and financial data updated to the most current figures available

Chapter 2

- New Opening Case about EpiPens
- New Entrepreneurship and New Ventures box about the concept of living wages
- New and/or updated examples throughout
- Finding a Better Way box updated
- New Managing in Turbulent Times box about Honey Pot

Chapter 3

- Updated Opening Case about Netflix and Reed Hastings
- All data and related information about small businesses and business ownership updated to the most current figures available
- New Finding a Better Way box about the rise of the gig economy
- New Entrepreneurship and New Ventures box focusing on microfinance
- New Managing in Turbulent Times box about Shake Shack

Chapter 4

- New Opening Case about Jack Ma and Alibaba
- All data and related information about global business activity updated to the most current figures available
- Discussion of USMCA, the trade agreement between the United States, Mexico, and Canada that replaces NAFTA
- Updated discussion of Brexit
- Updated Finding a Better Way box about manufacturing in Mexico and China
- New Entrepreneurship and New Ventures box about women entrepreneurs in international business
- New Managing in Turbulent Times box about Brexit

Chapter 5

- Updated Opening Case about The Body Shop
- New Finding a Better Way box about managing the contingent workforce
- Updated Entrepreneurship and New Ventures box about the role of middle managers
- New Managing in Turbulent Times box about data breaches

Chapter 6

- New Opening Case about Spotify
- New Finding a Better Way box about Holacracy
- Updated Entrepreneurship and New Ventures box about the growth of Soko Glam
- Updated Managing in Turbulent Times box about Illinois Tool Works

Chapter 7

- Updated Opening Case about Cheesecake Factory
- Updated data and statistics about manufacturing and service sectors
- New Finding a Better Way box about social responsibility in the Patagonia supply chain
- Updated Entrepreneurship and New Ventures box about meal delivery services
- Updated Managing in Turbulent Times box about the airline industry

Chapter 8

- New Opening Case about the Virgin Group Ltd.
- Finding a Better Way box about Cirque du Soleil
- Updated Entrepreneurship and New Ventures box about entrepreneur Sophia Amoruso
- Updated Managing in Turbulent Times box about workplace bullying

Chapter 9

- Updated Opening Case about Brad Smith
- Updated Finding a Better Way box about Ruzwana Bashir, founder and CEO of Peek
- Updated Entrepreneurship and New Ventures box about John Paul DeJoria, a serial entrepreneur
- Updated Managing in Turbulent Times box about Kasper Rørsted, CEO of Adidas

Chapter 10

- Updated Opening Case about Accor Hotels
- New Finding a Better Way box about NerdWallet
- New Entrepreneurship and New Ventures box about the role of artificial intelligence in recruitment
- Updated diversity statistics and data

Chapter 11

- New Opening Case about IKEA
- New Finding a Better Way box about the Expensify Card
- Updated Entrepreneurship and New Ventures box about small-acreage farming
- New Managing in Turbulent Times box about Iconik, a Santa Fe coffee shop

Chapter 12

- New Opening Case about marketing luxury cars
- New Finding a Better Way box about Brexit's impact on the fee status of European students in the United Kingdom
- New Entrepreneurship and New Ventures box about BedInABox
- Updated statistics about brand value
- Updated Managing in Turbulent Times box about Uber

Chapter 13

- Updated Opening Case about e-commerce
- Updated statistics and data about online retailing and advertising expenditures
- New Finding a Better Way box about trends in retailing
- Updated Entrepreneurship and New Ventures box about Algramo
- Updated Managing in Turbulent Times box about the role of automation and robotics in logistics

Chapter 14

- Entire chapter substantially revised to reflect the very latest research and practice related to information technology
- Revised Opening Case about information security, especially as it relates to individuals
- Extended discussion of data mining
- Extended discussion of enterprise resource planning
- Revised Finding a Better Way box about crowdsourcing
- Revised Entrepreneurship and New Ventures box about voice recognition technologies
- Revised Managing in Turbulent Times box about the role of IT in health care

Chapter 15

- Updated Opening Case about accounting scandals
- Revised Finding a Better Way box about the role of analytics in auditing
- Updated statistics and data for all in-text examples
- Updated examples about unethical and/or illegal accounting practices
- Updated Entrepreneurship and New Ventures box about how weak financial control systems can hurt businesses
- New Managing in Turbulent Times box about differences in accounting standards between the United States and other countries

Chapter 16

- Updated statistics and data about M-1, M-2, and interest rates
- New Finding a Better Way box about Venmo
- Updated Entrepreneurship and New Ventures box about BlackRock
- Updated Managing in Turbulent Times box about credit standards

Chapter 17

- Updated Opening Case about Dr. Martens
- Updated information about global stock exchanges
- Updated information about trends in bull and bear markets
- Revised Finding a Better Way box about pension plans and retirement planning
- New Entrepreneurship and New Ventures box about crowdfunding
- Updated Managing in Turbulent Times box about technological innovations in stock trading

New Features

This edition also adds a new feature called Integrative Learning Portfolio found at the end of each part. The three elements in each of these features are intended to help integrate various topics across different chapters. One element is called *Crafting a Business Plan*. This element focuses on the various stages in developing a business plan. The second element is an integrative case focusing on Ford Motor Company. Over the course of all six parts of the book, this case illustrates all aspects of business as they relate to Ford. Finally, the third element is called *Finding Your Path*. This element looks at job market trends, starting salaries, and various career paths. In addition, they also each have an employability component that examines how students can improve their prospects for finding an attractive job.

Cases

As described above, all cases have been updated or replaced. Covering a wide variety of topics and organizations, including Spotify, Netflix, and Accor Hotels, these real-world cases introduce relatable topics that draw students into the content of each chapter.



Nothing Magical About Alibaba

In September 2019 on his birthday and coinciding with the 20th anniversary of Alibaba, Jack Ma announced his retirement in a tearful speech to 80,000 Alibaba employees, during which he took the stage in a rock star costume, complete with wig and guitar. The path to that stage was a circuitous one. It took Ma Yun, aka Jack Ma, 4 years to pass the stringent entrance exams for college in China before he received a degree in English. He worked his way through graduate school, teaching English, to earn a degree in business but couldn't land a job in the tough Chinese job market. In the mid-1990s, a trip to the United States opened his eyes to the opportunities emerging on the Internet. Back in China, he started building rudimentary websites for Chinese companies. Two failed business attempts later, in 1999, he founded what is now known as the Alibaba Group, a family of online wholesale and retail companies. The empire began with Alibaba.com, a business-to-business platform that allowed even small businesses access to a vast network of sellers. Building upon this success, Ma launched Taobao and Tmall.com, retail sites targeting the burgeoning Chinese

Busy Chinese consumers rely on a variety of marketplaces for buying and selling goods. These include both traditional "physical" markets as well as online markets like Alibaba.

Current Events

The author has added new coverage of the COVID-19 pandemic and its economic impact, social unrest, the withdrawal of Great Britain from the European Union, the increasing diversity of the labor force, the continuing impact of social media, trends in information technology, and fluctuations in the U.S. economy. He has also added coverage of emerging new employment relationships. All data and statistics have also been updated to the most current information available.

End-of-Chapter Activities

Five kinds of chapter-ending involvement activities—to reinforce and practice the use of chapter concepts—are back by popular demand!

questions & exercises

QUESTIONS FOR REVIEW

- What are the World Bank's four classifications of countries based on per-capita income?
- What distinguishes an international business from a multinational business?
- What is the role of an independent agent in an international organization?
- Why might a business enter a strategic alliance?

QUESTIONS FOR ANALYSIS

- Although it is impossible to predict how different cultures might react, outline the meaning of social, power, uncertainty, goal, and time orientations as identified by Geert Hofstede and explain how they help us understand different cultures.
- Why are cultural factors sometimes a minor challenge to a manager and at other times a major one?
- Research and identify a quota imposed by your country on an imported product. Do you support that quota? If so, why?
- Overproduction in a particular country can lead to a global glut in supply. The consequences of this to domestic producers can be disastrous. What steps can governments take to prevent dumping in their domestic markets?

APPLICATION EXERCISES

- Identify a manufactured product (car, bike, computer, etc.) you think is made in the United States. Do some research and try to determine where the component parts are made. How much of your chosen product is actually made in the United States? List the parts and their countries of origin and identify the competitive advantage that you believe each place holds.
- China is one of the fastest-growing markets in the world. Use Web or database research to uncover how to best describe China according to the five cultural dimensions. Cite the sources for your information.

Solving Teaching and Learning Challenges

Many students who take Introduction to Business courses have difficulty seeing the relevance of course topics to their lives and future careers. This reduces the willingness of many students to prepare for class and to be engaged during class. We use the following resources to engage students with the content and to highlight how Introduction to Business is relevant and important for their employability and careers.

“What’s in It for Me?”

Students sometimes question the value of a particular major, class, or textbook. We have worked tirelessly to make sure that you see the value of this class and book. To help with this, each chapter opens with a special feature we call “What’s in It for Me?” This feature is intended to reinforce the notion of different roles, as described above. While each of the various roles—employee, employer, boss, consumer, and investor—are all important, this feature highlights some of the key implications for the different roles for each chapter.

Applied Learning Opportunities Throughout Business Cases and Features

Managing in Turbulent Times

- Students learn from disappointments, challenges, and opportunities real companies face.
- New features look at the effects of the COVID-19 pandemic, leadership in a virtual world, and workplace bullying.


managing in turbulent times

Brexit 2020

The European Union was formed after World War II to foster economic cooperation. Being part of the single market gave businesses easy access to all 500 million customers in the member countries and allowed consumers and companies to purchase goods and services from across the continent free of most tariffs and restrictions. It also allowed the relatively free movement of people across borders, much as the people of the United States are free to move from state to state. Even so, the British people had never been fully invested in the EU.

In 2015, as part of his campaign for reelection, British Prime Minister David Cameron promised to put a referendum on the ballot asking voters to decide if they wanted to exit the European Union (EU). The outcome he hoped for was a mandate from the public to remain with the EU, but on the day of the vote, with a 72 percent turnout, 51.9 percent of voters opted to leave. The pivotal issues turned out to be more sociological than economic: mostly a British desire for sovereignty and a fear of immigrants pouring into the country. Cameron, who had relied on the benefits of belonging to the EU as the cornerstone of his administration, resigned his post.

In July 2016, the Queen appointed Home Secretary Theresa May as prime minister, and the actual transition, now called Brexit, was left to her. After 3 years of struggling to broker a deal between the United Kingdom and the other members of the EU that would be acceptable to all parties, May resigned and the PM spot went to Boris Johnson. On January 31, 2020, the United Kingdom finally started its 11-month transition out of the EU.



Credit: iStockphoto.com

Meanwhile, in 2019, the Trump administration renegotiated the long-standing North American Free Trade Agreement and rebranded it the United States-Mexico-Canada Agreement (USMCA). When NAFTA took effect in 1994, it transformed the U.S. economy. It opened opportunities for businesses to seek inexpensive labor. It also reduced prices for consumers and created open access to products (particularly produce) from all three economies. The 2019 modification requires Mexico to ensure higher wages and increased legal protections for workers, and also includes provisions that increase copyright, patent, and trademark protections to make them more consistent and compatible with U.S. practices.

As the economic and political climates continue to change, we see traditional, long-standing relationships, treaties, and trade organizations struggling to keep up, and the process is not always neat and tidy, or even logical.

Finding a Better Way

- This boxed feature reveals examples of organizations that are “finding a better way” to meet business challenges and describes how they are doing it.

finding a better way

Car Wars: China Versus Mexico

In today’s competitive global economy, businesses strive for every possible advantage. Many manufacturers, for example, locate their factories in countries that have an ample supply of low-cost skilled labor. During the 1980s and 1990s, the place to be was Mexico. Hundreds of factories were built just across the U.S.–Mexican border, and workers streamed to the region from other parts of Mexico for stable and well-paying jobs. But in the late 1990s, the world started to shift.

Mexican prosperity, fueled in part by its role as a center of manufacturing, led to increases in the cost of living, followed quickly by wage increases so workers could keep up. At about that same time, China began to emerge as an attractive manufacturing alternative. Wages in China were roughly one-third the wages in Mexico, and there was no shortage of workers eager to take steady jobs in factories making products for other countries. China’s boom was Mexico’s bust as one company after another reduced or eliminated manufacturing there and moved to Asia.

In more recent years, the situation started to tilt back in Mexico’s favor. As China’s economy flourished, its labor costs crept higher and higher, and when U.S. manufacturers factored in shipping costs, producing auto parts in Mexico once again became more cost effective. Time differences between the United States and China also make phone and video conferencing difficult. In addition, U.S. companies have taken flak for China’s business practices. Companies are often heavily subsidized by the government, and low-paid workers are not offered the same benefits and protections as workers



Credit: iStockphoto.com

in the United States, causing what many deem to be an uneven playing field that takes jobs away from U.S. workers.

Because of these socioeconomic shifts, Mexico made enormous gains in the automobile sector. Companies such as Nissan, Honda, Volkswagen, and Mazda invested billions of dollars in Mexican companies, and by 2019 the country as a whole was producing about 350,000 units a month, rivaling production by China, even as the U.S. auto market was in a slump from too much inventory. By December, exports had tanked, but just 2 months later, in early 2020, when COVID-19 all but shut down China’s capacity to produce parts, Japanese and U.S. manufacturers turned full force to Mexico. So, the battle for competitive advantage continues, and the back-and-forth nature of the industry and its resultant ups and downs will likely continue for the foreseeable future.

Entrepreneurship and New Ventures

- This updated boxed feature shows students entrepreneurs who have really made a difference, some in large firms, others in smaller start-up companies.

entrepreneurship and new ventures

Women Entrepreneurs Grow Global

In 2008, Laurel Delaney started writing a blog, *Women Entrepreneurs Grow Global*, or *wegg*, focused on helping women entrepreneurs expand their businesses internationally. Delaney knew through personal experience that women-owned exporting businesses faced unique challenges. Inspired by an International Trade Centre report that “women-owned SMEs that export tend to earn more, pay more, employ more people and be more productive than firms that only operate domestically,” Delaney aimed to create a one-stop-shop resource where women could easily access educational resources.

In 2015, after observing that many of her clients were newer businesses with little extra-funding for continuing education or start-ups, Delaney incorporated as a 501(c)(3) to take advantage of grant and sponsorship funding. She expanded her online reach with different platforms like webinars and social media with catchy names like *wegginars* and Twitter *weggchats*, and began to offer one-to-one peer mentoring.

By early 2020, *wegg* had served over 1,800 women business owners and entrepreneurs. Its services now include access to specialists who provide tailored support and education and a VIP program for women CEOs to access operational, legal, and strategic support. Though primarily serving its clients online, allowing them to access support from anywhere, *wegg* also offers meetups and in-person mentoring.



Laurel Delaney/WEGG

Laurel Delaney has helped over 1,800 women entrepreneurs expand into international markets.

Beyond all the practical knowledge provided by *wegg*, Delaney stays focused on her original goal: “I wanted to change the landscape for women from being risk-averse to having confidence to go for it—with the appropriate support.”⁴⁹

Developing Skills for Your Career

For students to succeed in a rapidly changing job market, they should be aware of their career options and how to go about developing a variety of skills. In this book and MyLab, we focus on developing these skills in the following ways:

Communication: Communication is covered in several places throughout the book. For example, Chapter 5 discusses how leaders communicate the corporate culture, while Chapter 6 discusses how managers communicate the delegation process and how managers can use communication to offset errors in the grapevine.

Critical Thinking: Chapter 9 devotes specific attention to the decision-making process. Chapter 11 discusses the research process and research methods. Collaboration teams and team-based methods of organizing are discussed in Chapters 6 and 8. At the end of each chapter, there is also a continuing team exercise.

Business Ethics and Social Responsibility: Chapter 2 is entirely devoted to ethics and social responsibility.

Information Technology Application and Computing Skills: Chapter 14 is devoted to information technology application and computing skills for business.

In addition, this edition adds an all-new feature called *Finding Your Path*. Found at the end of each part of the book, these features look at job market trends, starting salaries, and various career paths. In addition, they also each have an employability component that examines how students can improve their prospects for finding an attractive job.

For more information and resources, visit www.pearson.com

Acknowledgments

This book bears the names of two authors. In reality, however, it reflects the combined efforts of many different people in what can only be called a team effort. First of all, we’d like to thank our reviewers and users who provided valuable feedback on the current strengths of the book and how we could make it better.

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I would also like to welcome Joe Cooke to the team. Joe is a professor at Santa Fe Community College. Joe helped update or replace the boxes and cases throughout the book and revised and enhanced all of the end-of-chapter pedagogy. In addition, my colleague at Texas A&M, Brad Wesner, helped with the substantial revision of Chapter 14. I would also like to acknowledge and express my gratitude to Ron Ebert. Ron and I worked on this book together for many years, and his imprint can still be found in many different places.

Finally, I would like to acknowledge my family. Their contributions to my work are far too extensive and personal to list. Suffice it to say that my wife, Glenda, and our children and grandchildren are the bedrock of my life. I am continually reminded by them of the fragility of life, the joy of being, and the importance of living every day to the fullest.

Ricky W. Griffin
 2020

P.S. (from Ricky)

I would also like to take a few lines here to personally acknowledge and express my gratitude to Ron Ebert. Ron retired from the University of Missouri–Columbia a few years ago after a long and distinguished career but continued to work with me on revisions of this book. However, he recently made the decision to retire from this work as well.

Ron was Chair of the Department of Management at Missouri when I completed my doctorate in 1978 and recruited me to join his department. Simply put, it was one of the best decisions of my life. I learned many lessons from Ron about scholarship, teaching, professionalism, and life and credit him for being one of my most significant mentors throughout my career. More importantly, though, he has been a wonderful friend. Ron, I miss working with you but will always treasure our friendship.

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about the authors

Ronald J. Ebert is Emeritus Professor at the University of Missouri–Columbia. Professor Ebert’s work has been based on more than thirty years of teaching experience at such schools as Sinclair College, University of Washington, University of Missouri, Lucian Blaga University of Sibiu (Romania), and Consortium International University (Italy). His consulting alliances have included such firms as Mobay Corporation, Kraft Foods, Oscar Mayer, Atlas Powder, and John Deere. He has designed and conducted management development programs for such diverse clients as the American Public Power Association, the U.S. Savings and Loan League, and the Central Missouri Manufacturing Training Consortium.

His experience as a practitioner fostered an advocacy for integrating concepts with best business practices in business education. The five business books he has coauthored have been translated into Spanish, Chinese (Simplified), Chinese (Traditional), Malaysian, Bahasa Indonesian, and Romanian languages. Professor Ebert has served as the Editor of the *Journal of Operations Management*. He is a Past President and Fellow of the Decision Sciences Institute. He has served as consultant and external evaluator for *Quantitative Reasoning for Business Studies*, an introduction-to-business project sponsored by the National Science Foundation. Professor Ebert retired from his role as co-author of this book after the publication of its 11th edition, but his imprint and myriad contributions can still be found in many different places throughout the text.



Ricky W. Griffin joined the faculty at Texas A&M University in 1981. During his career at Texas A&M, he has taught undergraduate and graduate courses in management, organizational behavior, human resource management, and international business. Professor Griffin’s research interests include workplace aggression and violence, organizational security, workplace culture, and leadership. His work has been published in such journals as *Academy of Management Review*, *Academy of Management Journal*, *Administrative Science Quarterly*, and *Journal of Management*. He served as Associate Editor and then as Editor of *Journal of Management*.

Professor Griffin has led executive development programs and/or consulted with such firms as Halliburton, Concho, KBR, Ascend, Shell Oil Company, Six Flags, and WinCo. He has also delivered invited presentations in England, Italy, France, Switzerland, Poland, Saudi Arabia, South Africa, Hong Kong, and Australia. He has also served as a consulting expert in numerous legal cases involving workplace violence and bullying and general human resource and talent management practices.

In addition, Professor Griffin has authored or coauthored several leading textbooks and coedited three scholarly books. His books have been used at more than 500 colleges and universities on five continents and have been translated into Spanish, Russian, Polish, and Chinese. He has served the Academy of Management as Chair of the Organizational Behavior Division and as Program Chair of the Research Methods Division. He also has served as President of the Southwest Division of the Academy of Management and on the Board of Directors of the Southern Management Association. Professor Griffin is a Fellow of both the Academy of Management and the Southern Management Association. He has also won several awards for research and has been supported by more than \$1,500,000 in external research funding. Professor Griffin has served as Director of the Center for Human Resource Management and Head of the Department of Management at Texas A&M University. He has also served as Executive Associate Dean and Interim Dean at the Mays Business School.



chapter 1

The Global Business Environment

PART 1 | THE CONTEMPORARY BUSINESS WORLD

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learning objectives

After reading this chapter, you should be able to:

- 1-1 Define** the nature of global business, describe the external environments of business, and discuss how these environments affect the success or failure of organizations.
- 1-2 Describe** the different types of global economic systems according to the means by which they control the factors of production.
- 1-3 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.
- 1-4 Explain** the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.
- 1-5 Learn** about the skills you will gain through this text.

what's in it for me?

As you will see in our Opening Case, economic, cultural, political, and technological forces have created challenges as well as opportunities for Lidl throughout the years, especially during its international expansion. All businesses are subject to the influences of economic forces. But these same economic forces also provide astute managers and entrepreneurs with opportunities for profits and growth. By understanding these economic forces and how they interact, you'll be better able to (1) appreciate how managers must contend with the challenges and opportunities resulting from economic forces from the standpoint of an employee and a manager or business owner, and (2) understand why prices fluctuate from the perspective of a consumer. You should have a deeper appreciation of the environment in which managers work and a better understanding of why the prices you pay for goods and services go up and down.

In this chapter, we'll first introduce the concepts of profit and loss and then describe the external environments of businesses. As we will see, the domestic business environment, the global business environment, and the technological, political-legal, sociocultural, and economic environments are also important. Next, we'll look at some basic elements of economic systems and describe the economics of market systems. We'll also introduce and discuss several indicators that are used to gauge the vitality of our domestic economic system.





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Big on Quality, Lidl on Price

Who wouldn't buy a product that's similar in quality to that of a rival but costs half its price? Offering high-quality produce at the lowest-possible price is exactly the strategy that led to the impressive domestic and international expansion of Lidl Stiftung & Co. KG, a German discount retailer chain. Lidl was first started by Anna Albrecht as a small grocery shop in Essen, Germany. When her two sons—known for their frugality—took over the business, they turned it into a fruit wholesaler (Albrecht KG) but maintained the former grocery shop's goal of keeping prices as low as possible, which proved to be a useful strategy given the store's location in a low-income neighborhood. In 1930, Joseph Schwarz joined the business, expanding it into a general supermarket. Unfortunately, World War II had devastating effects on the business, and the company suffered. It was inherited by Joseph's son, Dieter Schwarz, who rebuilt it and turned it into a discount supermarket chain, true to its origins. Interestingly, in what can probably now be recognized as a “branding and marketing” move, Dieter named it after his father's business partner Ludwig Lidl rather than using own family name. “Schwartz Markt” in German means “black market,” which would not have been an appealing name for a growing company. Lidl, with its name and logo as we know it today, thus came into being in Ludwigshafen, Germany, in 1973.

The chain grew quickly in Germany, becoming a key fierce competitor to its market rival Aldi, another German discount supermarket chain. While Aldi's self-branding in Germany is “the inventor of cheap,” Lidl's tagline in response is “the inventor of best quality and cheap.” Lidl's business model is to keep prices low through rigorous cost management, which is achieved by keeping the product range very limited, allowing each product to sell in higher volumes. This helps the customer purchase high-quality produce in bulk at low prices. It also makes the supply chain less complex and less risky. Lidl offers in-store shopping only, with a “no-frills” shop layout that's easy to manage with a limited staff. While it sells more branded products than Aldi, it also extensively employs private labeling, which helps ensure price competitiveness. Aldi has been operating longer as a chain and remains more popular with consumers, but Lidl, with over 3,200 branches across Germany in 2020, is a close second. Lidl's turnover growth has been impressive—up by 14.1 percent in 2013, 11.2 percent in 2014, and 12 percent in 2015 to €38.3 billion.

In the 1990s, Lidl began to actively conquer international markets, opening stores in most European countries. Currently, it is one of the biggest retailers globally—it operates in 32 countries and employs over 310,000 people. Lidl's second-biggest market in Europe (after France) is the United Kingdom, and its expansion shows well how the external environment shapes business development. Lidl entered the British market in 1994, starting with 10 stores. The chain fit in quite well, as British consumers were used to shopping in large supermarkets. Low prices as compared to the product quality helped Lidl gain popularity. The financial crisis of 2008 played a particularly significant role in Lidl's growth in popularity. As the United Kingdom's economy plunged into recession, unemployment rose and wages stagnated, while food inflation reached 13 percent. This meant that every penny mattered to consumers, and many had to shift down from mid-range stores. Lidl, with its general strategy already tailored to offer the

lowest possible prices, was therefore in a good position to lure away a large customer base from the United Kingdom's Big Four mainstream supermarkets—Tesco, Asda, Morrisons, and Sainsbury's. Its share of the British grocery market grew from 2 percent before the recession to 6 percent. In 2009, the chain opened its 500th store in the United Kingdom. Although the rivals tried to modify their pricing to stay in the race (Tesco for instance launched a value range, loyalty cards, price-match schemes, and so on), Lidl managed to retain many of its new customers owing to the quality of its produce.

The British economy took another hit after the Brexit talks of 2018. Lidl saw this as a potential opportunity to grow and, in 2019, announced that the chain would speed up its expansion to 1,000 stores across the United Kingdom by 2023. In March 2021, Lidl had 800 supermarkets and 13 regional distribution centers across the United Kingdom and employed over 24,500 people.

In addition to using the changes in the local economy to its advantage, Lidl also keeps pace with social and policy trends to stay competitive. For instance, in response to healthy-eating trends and government campaigns in the United Kingdom, Lidl has expanded its range of healthy food products, fruits and vegetables, and vegan and vegetarian options. Following the growing consumer awareness about topics such as corporate social responsibility (CSR) and climate change, Lidl has developed an extensive sustainability strategy. It sources locally produced fruit and vegetables, invests in local farms to ensure animal welfare, and sources products such as coffee, tea, and cocoa from Fair Trade-certified sustainable producers. It has also launched a range of initiatives to reduce food waste and plastic usage and pledged to reduce operational emissions. For instance, Lidl was the first UK supermarket to introduce reusable fruit and vegetable bags in 2019. Claire Farrant, Marketing Director at Lidl, says that the supermarket aims to set themselves apart from rivals by ensuring "that any cost associated with their environmental initiatives is never transferred to the customer."¹

However, a major challenge for Lidl arose at the start of the COVID-19 pandemic in 2020, when questions were raised about whether it would be able to maintain its competitive edge given its refusal to keep up with technological advances. Before the pandemic, Lidl offered in-store shopping only and had little digital presence apart from its website and the loyalty scheme offered on its mobile application, Lidl Plus. Although in 2018 it founded a digital logistics company, exploring the potential of online stores, it was dissolved in 2020 as it did not conform to Lidl's business model of simple and streamlined operations. But the nature of the COVID-19 crisis and government measures—including several nationwide lockdowns and work-from-home and stay-at-home directives—meant that online retail became crucial, and home delivery orders increased by almost 400 percent as compared to 2019. The Big Four supermarkets with established online shopping platforms and in-house delivery scaled up this demand. The sales of Tesco, Morrisons, and Sainsbury's increased by 13–16 percent in 2020, leaving the nontech-savvy Lidl behind. As the pandemic slowly receded, there was some indication that online shopping habits may be here to stay. In January 2021, online grocery shopping accounted for 15 percent share of the UK market, up from 8.7 percent in 2020.

So does Lidl need to adjust its strategy? After all, it recorded losses of £25 million pounds in the pre-pandemic year, which were mainly due to investments in new stores. Or is it, yet again, betting on more consumers looking for affordable and quality produce following the economic consequences of the pandemic? Emerging figures show that despite losing out on sales during the pandemic, in December 2020, Lidl's sales were up by 17.9 percent compared to the same period in 2019—growth higher than that of the rival Big Four. According to Lidl GB Chief Executive Christian Härtnagel, Lidl believes that the switch to online is not permanent, and Lidl remains confident in its strategy to open more stores across the United Kingdom, with 51 new ones planned for 2021. Will the business model continue to be successful? Only time will tell. (After studying the content in this chapter, you should be able to answer the set of discussion questions found at the end of the chapter.)

Business, Profit, and the External Environment

OBJECTIVE 1-1

Define the nature of global business, describe the external environments of business, and discuss how these environments affect the success or failure of organizations.

Business organization that provides goods or services to earn profits

Profits difference between a business's revenues and its expenses

What do you think of when you hear the word *business*? Does it conjure up images of large, successful corporations, such as Apple, Starbucks, and Amazon? Or of once-great but now struggling companies like Sears and Yahoo!? Do you think of multinational giants such as Honda, General Electric, or Nestlé? Are you reminded of smaller firms down the street, such as your local supermarket or favorite chain restaurant? Or do you think of even smaller family-owned operations, such as your neighborhood pizzeria, dry cleaners, or the florist around the corner?

Business and Profit

All these organizations are **businesses**, organizations that provide goods or services that are then sold to earn profits. Indeed, the prospect of earning **profits**, the difference between a business's revenues and its expenses, is what encourages people to open and expand businesses. After all, profits are the rewards owners get for risking their money and time. The right to pursue profits distinguishes a business from those organizations—such as most state universities, hospitals, and government agencies—that run in much the same way but that generally don't seek profits.²

Consumer Choice and Demand In a capitalistic system, businesses exist to earn profits for owners; within certain broad constraints, an owner is free to set up a new business, grow that business, sell it, or even shut it down. But consumers also have freedom of choice. In choosing how to pursue profits, businesses must take into account what consumers want or need. No matter how efficient a business is, it won't survive if there is no demand for its goods or services. Neither a surf shop in landlocked Austria nor a ski store in tropical Thailand is likely to do well.

Opportunity and Enterprise If enterprising businesspeople can spot a promising opportunity and then develop a good plan for capitalizing on it, they can succeed. For example, when large businesses such as Virgin Megastore, Saab AB, and Toys“R”Us close their doors, other firms profit from these closings by handling the inventory liquidations of these failed companies. And as oil prices recently dropped, gasoline producers like ExxonMobil and BP have seen their profits decline. However, food distributors like Sysco and delivery services such as FedEx saw their expenses drop due to lower fuel costs and hence their profits grow. In general, then, business opportunity involves goods or services that consumers need or want—especially if no one else is supplying them or if existing businesses are doing so inefficiently or incompletely.

The Benefits of Business So what are the benefits of businesses? Businesses produce most of the goods and services we consume, and they employ most working people. They create most innovations and provide a vast range of opportunities for new businesses, which serve as their suppliers. A healthy business climate also contributes to the quality of life and standard of living of people in a society. Business profits enhance the personal incomes of millions of owners and stockholders, and business taxes help to support governments at all levels. Many businesses support charities and provide community leadership. However, some businesses also harm the earth's environment, and their decision makers sometimes resort to unacceptable practices for their own personal benefit.

We now turn our attention to the environment in which businesses operate. Understanding the environment provides a foundation for our subsequent discussions dealing with economic forces that play a major role in the success and failure of businesses everywhere.

The External Environments of Business

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 thorough 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. As you can see, these include the *domestic business environment*, the *global business environment*, the *technological environment*, the *political-legal environment*, the *sociocultural environment*, and the *economic environment*.

External Environment
everything outside an organization's boundaries that might affect it

Domestic Business Environment The **domestic business environment** refers to the environment in which a firm conducts its operations and derives its revenues. In general, businesses seek to be close to their customers, to establish strong relationships with their suppliers, and to distinguish themselves from their competitors. Take Swedish retailer H&M, for example. The firm began with a single store selling women's clothing, but with the acquisition of Mauritz Widforss the company expanded into men's and children's clothing in the 1960s. With a strong focus on marketing and fashionable clothing, the company was able to expand rapidly. It has

Domestic Business Environment
the environment in which a firm conducts its operations and derives its revenues



FIGURE 1.1 Dimensions of the External Environment

finding a better way

Saving the World One Camp Stove at a Time

Unsafe drinking water and household air pollution are major causes of illness and death around the world. In Rwanda, where most people living in rural areas cook their meals on open stoves, smoke and fumes from fuel such as wood and charcoal have been linked to pneumonia, low birth weight, and impaired development in children. The Rwandan government has tried for years to address this issue, along with the lack of safe drinking water, but the efforts lacked financial support.

As a general rule, we expect a free market system to react to consumer needs, but that doesn't always happen. Business seeks profit, and not all consumer needs are profitable, such as clean-burning stoves for Ugandan families. Nonprofit organizations like the Red Cross work to serve the public good or solve social problems, but those organizations can't supply every demand. Enter the B Corporation (B Corp).

B Corps are for-profit businesses that volunteer to be graded by the nonprofit B Lab each year to ensure they're meeting the highest standards of social and environmental performance, public transparency, and legal accountability. Corporate performance is measured not only by profits or growth in stock price but also by the organization's impact on society and the environment. EcoZoom started out as a successful B Corp.

After a successful career in the transportation industry, EcoZoom founder Ben West went back to school to earn an MBA. One of his professors was on the board of directors of Aprovecho, a nonprofit that designed cookstoves for use in developing countries. Although Aprovecho had developed great technology, the nonprofit didn't know how to get the product to the market. West decided he could do something about that, and so he started his company in 2011. Now, EcoZoom manufactures stoves in China, and although it sells them in the United States for camping and other outdoor uses, its primary market is developing countries, such as Rwanda, where women and children are being exposed to toxic smoke from inefficient stoves that make them more susceptible to acute illnesses such as pneumonia, lung cancer, and heart disease.



EcoZoom

In addition to reducing air pollution inside and around the home, EcoZoom's low-emission, energy-efficient cookstoves reduce fuel use and cooking time, giving people more time to spend with their families and on other tasks, such as maintaining their gardens. The stoves can burn traditional biomass fuels, such as corn cobs and cow dung, as well as wood and charcoal. Since fuel costs can run up to 30 percent of a family's monthly income, the simple addition of an efficient stove makes a huge difference.

EcoZoom is providing stoves to a host of other African countries and is expanding distribution globally to wherever it is most needed. As EcoZoom's mission states: "We believe that household products should be healthy, efficient and eco-friendly for everyone, regardless of socio-economic status. A global social enterprise, our products are changing lives in 23 countries worldwide." Interestingly, however, EcoZoom recently dropped its status as a B Corp because of the high annual fee required to participate. The firm remains committed, though, to its original mission and continues to work to make the world a better place.³

established a clear identity for itself within the domestic business environment that enables it to compete effectively with such players as Acne Studios and Filippa K.

Global Business Environment
the international forces that affect a business

Global Business Environment The **global business environment** refers to the international forces that affect a business. Factors affecting the global environment at a general level include international trade agreements, international economic conditions, political unrest, and so forth. For example, as the effects of the 2020 COVID-19 pandemic in China began to spread, travel in that country plummeted. As a result, demand for fuel dropped in China, creating a surplus in other countries and leading to a fall in retail gasoline prices. Likewise, international air travel plunged as

the virus spread around the globe. At a more immediate level, any given business is likely to be affected by international market opportunities, suppliers, cultures, competitors, and currency values. For instance, H&M currently has stores in Sweden, Germany, the United Arab Emirates, France, Spain, the United Kingdom, China, Poland, United States, and other countries, and it ships to customers in an additional 45 countries. But as it has expanded into other parts of the world, it has had to contend with different languages, more diverse cultures, different tastes, different currencies, and many other factors. Complicating things further, its suppliers are based all around the world.

Technological Environment The **technological environment** generally includes all the ways by which firms create value for their constituents. Technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems that are used to perform business activities. For example, to be highly responsive to its customers, H&M relies on a sophisticated information system that tracks sales and inventory levels. The company also enjoys considerable success with its e-commerce operations. H&M pioneered the use of mobile applications to engage consumers and generate sales through app features, such as online sales and virtual reality product showcases, that are taken for granted in e-commerce today. The digitalization of H&M has led to a strong overall market presence across the globe as the post-pandemic world shifts to online shopping.

Technological Environment *all the ways by which firms create value for their constituents*

Political-Legal Environment The **political-legal environment** reflects the relationship between business and government, usually in the form of government regulation of business. This environment is important for several reasons. First, the legal system defines in part what an organization can and cannot do. For example, H&M is subject to a variety of political and legal forces, including product identification laws, employment laws, tax policies, and competition regulation. Likewise, various government agencies regulate important activities, such as advertising practices, safety and health considerations, and acceptable standards of business conduct. Pro- or antibusiness sentiment in government and political stability are also important considerations, especially for international firms. For instance, shortly after President Barack Obama first took office, a number of new regulations were imposed on businesses. Among other things, he signed legislation that imposed new restrictions on lobbying and on political action committees (these regulations are discussed in Chapter 2). But after Donald Trump was elected president in 2016, he pledged to reduce what he called excessive government regulation. Carrying through on this promise, he did cut or reduce several regulations, most of which involved banking and environmental protection.

Political-Legal Environment *the relationship between business and government*

Sociocultural Environment The **sociocultural environment** includes the customs, mores, values, and demographic characteristics of the society in which an organization functions. Sociocultural processes also determine the goods and services, as well as the standards of business conduct, that a society is likely to value and accept. Recently, there has been a greater emphasis in society on sustainability and recycling. H&M has responded to this by introducing a recycling scheme that encourages customers to bring unwanted clothes into stores in return for a discount towards a future purchase. These can then be sent for recycling and reuse. However, H&M has also faced a number of controversies in recent years, such as the accusations of racism when a black child modelled for the brand wearing a sweatshirt bearing a slogan considered highly offensive and derogatory. A number of musicians who collaborated with the retailer immediately cancelled partnerships with the company. H&M apologized for the incident, and the images were removed from their websites around the world.⁴

Sociocultural Environment *the customs, mores, values, and demographic characteristics of the society in which an organization functions*

Economic Environment The **economic environment** refers to relevant conditions that exist in the economic system in which a company operates. For example, if an economy is doing well enough that most people have jobs and wages are high,

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



H&M is affected by the external environment in many different ways. The domestic business environment, global business environment, technological environment, political-legal environment, sociocultural environment, and economic environment all interact to provide the company with opportunities as well as challenges.

a growing company may find it necessary to pay even higher wages and offer more benefits to attract workers from other companies. But if many people in an economy are looking for jobs, a firm may be able to pay less and offer fewer benefits. Like many retailers, H&M experienced financial pressures due to recessions and changing consumer spending habits. As with other brick-and-mortar retailers, H&M faces intense competition from online retailers and is closing numerous underperforming stores as well as slowing the pace of growth in store openings as their customers continue to move online. The rest of this chapter is devoted to the economic environment; the other environments of business are covered throughout the rest of the book.

OBJECTIVE 1-2

Describe the different types of global economic systems according to the means by which they control the factors of production.

Economic System *a nation's system for allocating its resources among its citizens*

Factors of Production *resources used in the production of goods and services—labor, capital, entrepreneurs, physical resources, and information resources*

Economic Systems

A U.S. business operates differently from a business in France or the People's Republic of China, and businesses in those countries differ from those in Japan or Brazil. A key factor in these differences is the economic system of a firm's *home country*, the nation in which it does most of its business. An **economic system** is a nation's system for allocating its resources among its citizens, both individuals and organizations.

Factors of Production

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. Economists have long focused on four factors of production: *labor, capital, entrepreneurs, and physical resources*. In addition to these traditional four factors, many economists now include *information resources*. Note that the concept of factors of production can also be applied to the resources that an individual organization *manages* to produce tangible goods and intangible services.

Labor People who work for businesses provide labor. **Labor**, sometimes called **human resources** or *human capital*, includes the physical and intellectual contributions people make while engaged in economic production. Starbucks, for example, employs almost 300,000 people.⁵ The firm's workforce includes the baristas who prepare coffees for customers, store managers, regional managers, coffee tasters, quality control experts, coffee buyers, marketing experts, financial specialists, and other specialized workers and managers.

Labor (Human Resources) *physical and mental capabilities of people as they contribute to economic production*

Capital Obtaining and using labor and other resources requires **capital**, the financial resources needed to operate a business. You need capital to start a new business and then to keep it running and growing. For example, when Howard Schultz decided to buy the fledgling Starbucks coffee outfit back in 1987, he used personal savings and a loan to finance his acquisition. As Starbucks grew, he came to rely more on Starbucks's profits. Eventually, the firm sold stock to other investors to raise even more money. Starbucks continues to rely on a blend of current earnings and both short- and long-term debt to finance its operations and fuel its growth. Moreover, even when the firm decided to close 150 underperforming coffee shops in 2019, it used capital to pay off leases and provide severance pay to employees who lost their jobs.

Capital *funds needed to create and operate a business enterprise*

Entrepreneurs An **entrepreneur** is a person who accepts the risks and opportunities entailed in creating and operating a new business. Three individuals founded Starbucks back in 1971 and planned to emphasize wholesale distribution of fresh coffee beans. However, they lacked the interest or the vision to see the retail potential for coffee. Schultz, however, was willing to accept the risks associated with retail growth, and after buying the company, he capitalized on the market opportunities for rapid growth. Had his original venture failed, Schultz would have lost most of his savings. Most economic systems encourage entrepreneurs, both to start new businesses and to make the decisions that allow them to create new jobs and make more profits for their owners.

Entrepreneur *businessperson or individual who accepts the risks and opportunities involved in creating and operating a new business venture*

Physical Resources **Physical resources** are the tangible things that organizations use to conduct their business. They include natural resources and raw

Physical Resources *tangible items that organizations use in the conduct of their businesses*



Alamy Stock Photo

(a)



dpa picture alliance/Alamy Stock Photo

(b)



Visual Intermezzo/Shutterstock

(c)



superoke/Shutterstock

(d)

Starbucks is the largest chain of coffee shops in the world. The company uses various factors of production, including (a) labor, such as these Starbucks baristas; (b) entrepreneurship, such as former CEO Howard Schultz; (c) physical resources, like these coffee beans; and (d) information like economic forecasts and coffee bean pricing data.

materials, offices, storage and production facilities, parts and supplies, computers and peripherals, and a variety of other equipment. For example, Starbucks relies on coffee beans and other food products, the equipment it uses to make its coffee drinks, and paper products for packaging, as well as office equipment and storage facilities for running its business at the corporate level.

Information Resources *data and other information used by businesses*

Information Resources The production of tangible goods once dominated most economic systems. Today, **information resources**, data and other information used by businesses, play a major role. Information resources that businesses rely on include market forecasts, the specialized knowledge of people, and economic data. In turn, much of what businesses do with the information results either in the creation of new information or the repackaging of existing information for new users. For example, Starbucks uses various economic statistics to decide where to open new outlets. It also uses sophisticated forecasting models to predict the future prices of coffee beans. And consumer taste tests help the firm decide when to introduce new products.

Types of Economic Systems

Different types of economic systems view these factors of production differently. In some systems, for example (and in theory), the ownership of both the factors of production and the actual businesses is private; that is, ownership is held by entrepreneurs, individual investors, and other businesses. As discussed next, these are market economies. In other systems, though (and also in theory), the factors of production and all businesses are owned or controlled by the government. These are called *planned economies*. Note that we described these kinds of systems as being “in theory.” Why? Because in reality, most systems fall between these extremes.

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*

Market Economy *economy in which individuals control production and allocation decisions through supply and demand*

Communism *political system in which the government owns and operates all factors of production*

Economic systems also differ in the ways decisions are made about production and allocation. A **planned economy** relies on a centralized government to control all or most factors of production and to make all or most production and allocation decisions. In a **market economy**, individual producers and consumers control production and allocation by creating combinations of supply and demand. Let’s look at each of these types of economic systems as well as mixed market economies in more detail.

Planned Economies Planned economies take two basic forms: *communism* (discussed here) and *socialism* (discussed later as a form of mixed market economy). As envisioned by nineteenth-century German economist Karl Marx, **communism** is a system in which the government owns and operates all factors of production. Under such a system, the government would assign people to jobs; it would also own all business and control business decisions—what to make, how much to charge, and so forth. Marx proposed that individuals would contribute according to their abilities and receive benefits according to their needs. He also expected government ownership of production factors to be temporary; once society had matured, government would wither away, and workers would take direct ownership of the factors of production.

The former Soviet Union and many Eastern European countries embraced communism until the end of the twentieth century. In the early 1990s, however, one country after another renounced communism as both an economic and a political system. Today, North Korea, Vietnam, Laos, Cuba, and the People’s Republic of China are the only nations remaining that are controlled by communist parties. However, China in particular now functions much more like a mixed market economy (discussed below) than a pure communist-based economy.

Market *mechanism for exchange between buyers and sellers of a particular good or service*

Market Economies A **market** is a mechanism for exchange between the buyers and sellers of a particular good or service. (Like *capital*, the term *market* can have multiple meanings.) 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 (within certain limits). As a result, items produced and prices paid are largely determined by supply and demand. The underlying premise of a market

entrepreneurship and new ventures

Luxury on a Budget

In 2014, Rich Fulop found himself “downsized” from his job as a finance manager, but he took that as an opportunity to go back to school at NYU’s Stern School of Business, while his wife, Vicki, worked at a public relations firm. After a few years of long hours and hard work, they splurged on a much-needed vacation, where they were enthralled by the posh hotel’s luxurious bed linens. When they came back home to New York, they went online looking for those same sheets. What they found instead was an opportunity. With a bit of paperwork, they created Brooklinen—an online retail outlet for quality sheets at an affordable price that would feature a satisfying shopping experience.

Using their combined business skills in finance and marketing, Rich and Vicki created a lean and profitable company in just a few years. By negotiating a manufacturing deal with a company in Israel, where the United States has free-trade agreements, they were able to cut costs by 22 percent, allowing them to sell high-quality sheets for between \$100 and \$200—expensive, but still a fraction of the price of Frette or Sferra sheets that sell for up to \$1,000.

By 2017, Brooklinen had over 150,000 customers and was doing \$50 million in sales, and expansion plans got a \$10 million boost from a venture capitalist. But, as with any good idea, the Fulops weren’t the only ones to see a need and fill it. At the same time they were launching their company, Ariel Kaye, tired of being just another face in a huge marketing firm, set out on her own, using Instagram to bring her Parachute home decor brand name to prominence.

Scott and Missy Tannen have a start-up story similar to that of the Fulops, but their concern was with ecoconscious sourcing, and so they started Boll & Branch to give consumers a pure, chemical-free, and socially responsible set of bed sheets. More recently, Rana Argenio left her job at Goldman



Igor Golovnov/Alamy Stock Photo

Sachs to launch her own company, 10 Grove, which ties into her family’s Texas-based linen factory, which in turn gets raw materials directly from a partner mill in Italy.

Brooklinen’s response to increased competition has been to continue to tweak its model by adding complementary products and partnering with businesses like Floyd Inc., a maker of bed frames and bookshelves focusing on sustainability, and Newgate World, a boutique clock store. Recently, the Fulops opened a “pop-up shop” with limited hours in Brooklyn near the East River to positive reviews and social media buzz.

All this competition drives prices down, which is good for customers and is a lynchpin of the capitalist system. It can be hard on the entrepreneur, though, as the market settles into an equilibrium state, in which profits dwindle until new companies lack motivation to provide more of the same product or service. In addition, customer tastes and preferences change over time. For companies like Brooklinen, the key to long-term success is to keep innovating and responding to the market.

economy is to create shared value—in theory, at least, effective businesses benefit because they earn profits on what they sell, and customers also benefit by getting what they want for the best price available.⁶

To understand how a market economy works, consider what happens when you go to a fruit market to buy apples. One vendor is selling apples for \$1 per pound; another is charging \$1.50. Both vendors are free to charge what they want, and you are free to buy what you choose. If both vendors’ apples are of the same quality, you will buy the cheaper ones. If the \$1.50 apples are fresher and healthier looking, you may buy them instead. In short, both buyers and sellers enjoy freedom of choice; that is, the vendors are free to charge whatever price they choose for their apples, and the customer is free to decide whether to buy the \$1 apples, the \$1.50 apples, someone else’s apples, or no apples at all.

Taken to a more general level of discussion, individuals in a market system are free not only to buy what they want but also to work where they want and to invest, save, or spend their money in whatever manner they choose. Likewise, businesses are free to decide what products to make, where to sell them, and what prices to charge.

Capitalism *system that sanctions the private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive*

Mixed Market Economy *economic system featuring characteristics of both planned and market economies*

Privatization *process of converting government enterprises into privately owned companies*

Socialism *planned economic system in which the government owns and operates only selected major sources of production*

This process contrasts markedly with that of a planned economy, in which individuals may be told where they can and cannot work, companies may be told what they can and cannot make, and consumers may have little or no choice in what they purchase or how much they pay. The political basis of market processes is called **capitalism**, which allows the private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive. The economic basis of market processes is the operation of demand and supply, which we discuss in the next section.

Mixed Market Economies In reality, no “pure” planned or “pure” market economies really exist. Most countries rely on some form of **mixed market economy** that features characteristics of both planned and market economies. Even a market economy that strives to be as free and open as possible, such as 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. And the People’s Republic of China, the world’s most important planned economy, is increasingly allowing private ownership and entrepreneurship (although with government oversight). Indeed, it is probably more accurate today to describe China as a mixed market economy in a country controlled by the communist party.

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 Poland, for example, the national airline was sold to a group of private investors. 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. The Netherlands, however, privatized its TNT Post Group N.V. (now called Post NL), and it is among the world’s most efficient post office operations. Canada has also privatized its air traffic control system. In each case, the new enterprise reduced its payroll, boosted efficiency and productivity, and quickly became profitable. More recently, the government of Iran has privatized numerous oil refineries and petrochemical plants that were previously state owned (although they have not revealed their productivity data).

In the partially planned system called **socialism**, the government owns and operates selected major industries. In such mixed market economies, the government may control banking, transportation, or industries producing basic goods such as oil and



Songquan Deng/Shutterstock

Many formerly planned economies have moved toward a more mixed economic model. For example, the People’s Republic of China has used a planned economic model for decades but is now moving more toward a mixed market economy. These signs on a busy Beijing street, for instance, are promoting a variety of goods and services provided by merchants along the street and are very consistent with a mixed economic model.

steel. Smaller businesses, such as clothing stores and restaurants, though, are privately owned. Many Western European countries, including England and France, allow free market operations in most economic areas but keep government control of others, such as health care. In the United States, the debate over how best to handle health care is often tied to socialism, at least in the rhetoric of politicians. For instance, many opponents of universal or national health care characterize such measures as being socialist.

The Economics of Market Systems

Understanding the complex nature of the global economic system is essential to understanding the environment in which businesses operate. In this section, we describe the workings of the global market economy. Specifically, we examine the nature of *demand and supply*, *private enterprise*, and *degrees of competition*. We will then discuss private enterprise and forms of competition.

Demand and Supply in a Market Economy

A market economy consists of many different markets that function within that economy. As a consumer, for instance, the choices you have and the prices you pay for gas, food, clothing, and entertainment are all governed by different sets of market forces. Businesses also have many different choices about buying and selling their products. Dell Computer, for instance, can purchase keyboards from literally hundreds of different manufacturers. In addition to deciding where to buy supplies, its managers also have to decide what inventory levels should be, at what prices they should sell their goods, and how they will distribute these goods. Similarly, online retailers like Amazon can decide to use FedEx, UPS, or the U.S. Postal Service to deliver products bought by customers. Literally billions of exchanges take place every day between businesses and individuals; between businesses; and among individuals, businesses, and governments. Moreover, exchanges conducted in one area often affect exchanges elsewhere. For instance, when gas prices are high, this may also lead to prices going up for other products, ranging from food to clothing to delivery services. Why? Because each of these businesses relies heavily on gas to transport products.

The Laws of Demand and Supply On all economic levels, decisions about what to buy and what to sell are determined primarily by the forces of demand and supply.⁷ **Demand** is the willingness and ability of buyers to purchase a product (a good or a service). **Supply** is the willingness and ability of producers to offer a good or service for sale. Generally speaking, demand and supply follow basic laws:

- 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*.

THE DEMAND AND SUPPLY SCHEDULE To appreciate these laws in action, consider the market for pizza in your town (or neighborhood). If everyone is willing to pay \$25 for a pizza (a relatively high price), the town's only pizzeria will produce a large supply. But if everyone is willing to pay only \$5 (a relatively low price), it will make fewer pizzas. Through careful analysis, we can determine how many pizzas will be sold at different prices. These results, called a **demand and supply schedule**, are obtained from marketing research, historical data, and other studies of the market. Properly applied, they reveal the relationships among different levels of demand and supply at different price levels.

OBJECTIVE 1-3

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.

Demand the willingness and ability of buyers to purchase a good or service

Supply the willingness and ability of producers to offer a good or service for sale

Law of Demand principle that buyers will purchase (demand) more of a product as its price drops and less as its price increases

Law of Supply principle that producers will offer (supply) more of a product for sale as its price rises and less as its price drops

Demand and Supply Schedule assessment of the relationships among different levels of demand and supply at different price levels

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

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

Market Price (Equilibrium Price) profit-maximizing price at which the quantity of goods demanded and the quantity of goods supplied are equal

DEMAND AND SUPPLY CURVES The demand and supply schedule can be used to construct demand and supply curves for pizza in your town. A **demand curve** shows how many products—in this case, pizzas—will be demanded (bought) at different prices. A **supply curve** shows how many pizzas will be supplied (baked or offered for sale) at different prices.

Figure 1.2 shows demand and supply curves for pizzas. As you can see, 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. In Figure 1.2, the

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

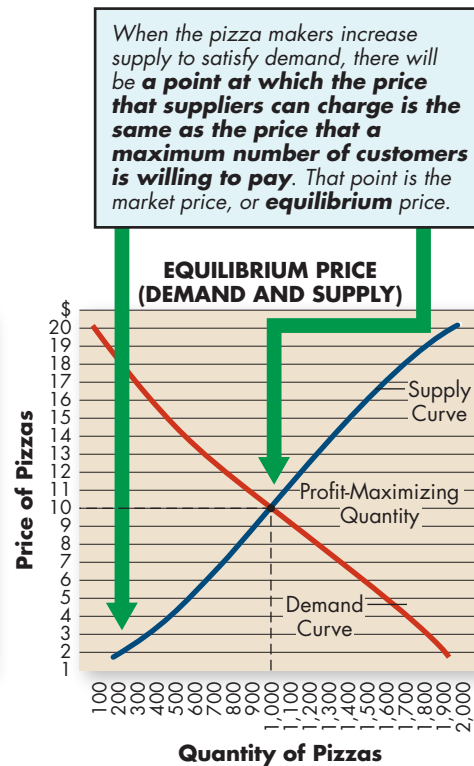
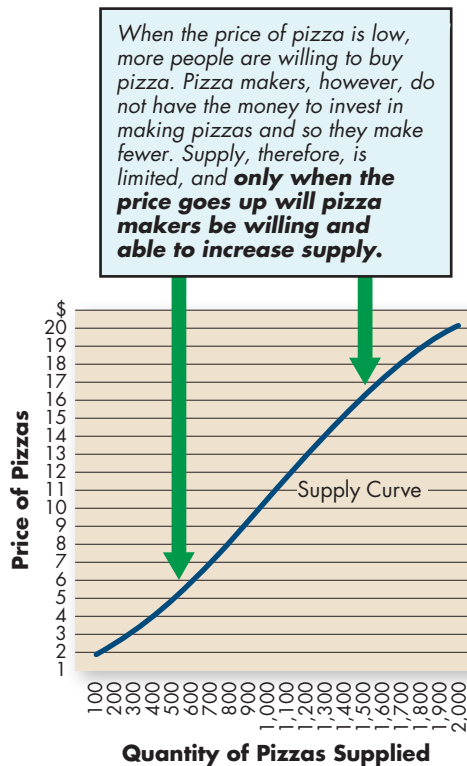
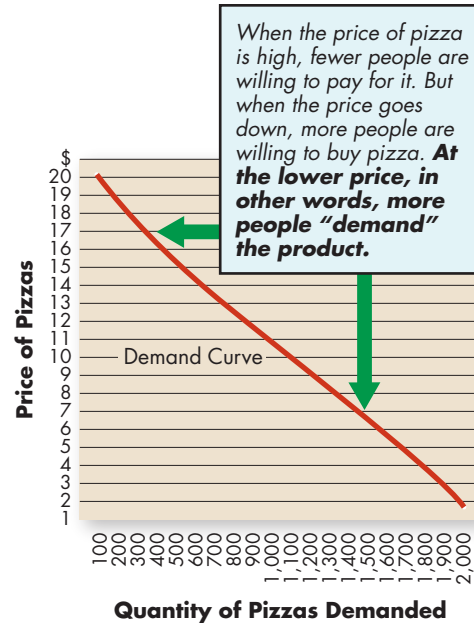


FIGURE 1.2 Demand and Supply

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.

SURPLUSES AND SHORTAGES What if the pizzeria decides to make some other number of pizzas? For example, what would happen if the owner tried to increase profits by making *more* pizzas to sell? Or what if the owner wanted to lower overhead, cut back on store hours, and *reduce* the number of pizzas offered for sale? In either case, the result would be an inefficient use of resources and lower profits. For instance, if the pizzeria supplies 1,200 pizzas and tries to sell them for \$10 each, 200 pizzas will not be bought. Our demand schedule shows that only 1,000 pizzas will be demanded at this price. The pizzeria will therefore have a **surplus**, a situation in which the quantity supplied exceeds the quantity demanded. It will lose the money that it spent making those extra 200 pizzas.

Conversely, if the pizzeria supplies only 800 pizzas, a **shortage** will result, meaning the quantity demanded will be greater than the quantity supplied. The pizzeria will “lose” the extra profit that it could have made by producing 200 more pizzas. Even though consumers may pay more for pizzas because of the shortage, the pizzeria will still earn lower total profits than if it had made 1,000 pizzas. It will also risk angering customers who cannot buy pizzas and encourage other entrepreneurs to set up competing pizzerias to satisfy unmet demand. Businesses should seek the ideal combination of price charged and quantity supplied so as to maximize profits, maintain goodwill among customers, and discourage competition. This ideal combination is found at the equilibrium point.

This simple example involves only one company, one product, and a few buyers. The global economy, however, is far more complex. Millions of transactions take place every day, but in the end, the result is much the same: Companies try to supply the quantity and selection of goods that will earn them the largest profits. For example, most families vacation during the summer months when children are out of school. As a result, airlines increase their capacity to popular travel destinations; and hotels, resorts, and car rental agencies at those destinations adjust their rates to account for the increased demand. But when September rolls around, airlines adjust their routes to other destinations and many summer resorts start to lower their rates. Adjustments then continue throughout the year to account for demand fluctuations during ski season, spring break, long weekends, and other times that people may decide to take vacations.

Private Enterprise and Competition in a Market Economy

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.

- 1 **Private property rights.** 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. You can also choose which products to buy, and producers can usually choose whom to hire and what to produce.
- 3 **Profits.** The attraction of profits (and freedom) leads some people to abandon the security of working for someone else and to assume the risks of entrepreneurship. Anticipated profits also influence individuals’ choices of which goods or services to produce.
- 4 **Competition.** If profits motivate individuals to start businesses, competition motivates them to operate those businesses efficiently. **Competition** occurs when two or more businesses vie for the same resources or customers. To gain an advantage over competitors, a business must produce its goods or services

Surplus situation in which quantity supplied exceeds quantity demanded

Shortage situation in which quantity demanded exceeds quantity supplied

Private Enterprise economic system that allows individuals to pursue their own interests without undue governmental restriction

Competition vying among businesses for the same resources or customers

efficiently and be able to sell at a reasonable profit. To achieve these goals, it must convince customers that its products are either better or less expensive than those of its competitors. Competition, therefore, forces all businesses to make products better or cheaper or both. A company that produces inferior, expensive products is likely to fail.

Degrees of Competition Even in a free enterprise system, not all industries are equally competitive. Economists have identified four degrees of competition in a private enterprise system: *perfect competition*, *monopolistic competition*, *oligopoly*, and *monopoly*. Note that these are not always truly distinct categories but instead tend to fall along a continuum; perfect competition and monopoly anchor the ends of the continuum, with monopolistic competition and oligopoly falling in between. Table 1.1 summarizes the features of these four degrees of competition.

Perfect Competition *market or industry characterized by numerous small firms producing an identical product*

PERFECT COMPETITION 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. 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.

Salt production is a good example of perfect competition. The salt produced by one business is the same as that by another. Both producers and buyers are aware of prevailing market prices. It is relatively easy to start producing salt and relatively easy to stop when it's no longer profitable.

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

MONOPOLISTIC COMPETITION In **monopolistic competition**, numerous sellers are trying to make their products at least seem to be different from those of competitors. Although many sellers are involved in monopolistic competition, there tend to be fewer than in pure competition. Differentiating strategies include brand names (Tide versus Cheer versus in-store house brands of detergent), design or styling (Diesel

table 1.1 Degrees of Competition

Characteristic	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Example	Local farmer	Office supply 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

versus Lucky versus True Religion jeans), and advertising (Coke versus Pepsi versus Dr Pepper). For example, in an effort to attract weight-conscious consumers, Kraft Foods promotes such differentiated products as low-fat Cool Whip, low-calorie Jell-O, and sugar-free Kool-Aid.

Monopolistically competitive businesses may be large or small, but they can still enter or leave the market easily. For example, many local coffee shops and pizza parlors compete successfully with much larger firms like Starbucks and Pizza Hut. Likewise, many single-store clothing businesses in college towns compete by developing their own T-shirt and baseball cap designs with copyrighted slogans and logos.

Product differentiation also gives sellers some control over prices. For instance, even though Target shirts may have similar styling and other features, Ralph Lauren Polo shirts can be priced with little regard for lower Target prices. But the large number of buyers relative to sellers applies potential limits to prices; although Polo might be able to sell shirts for \$20 more than a comparable Target shirt, it could not sell as many shirts if they were priced at \$200 more.

OLIGOPOLY 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. Thus, oligopolistic industries (automobile, airline, and steel industries) tend to stay that way. Only two companies make large commercial aircraft: Boeing (a U.S. company) and Airbus (a European consortium). Furthermore, if the trend toward globalization continues, most experts believe that oligopolies will become increasingly prevalent.

Oligopolists have more control over their strategies than do monopolistically competitive firms, but the actions of one firm can significantly affect the sales of every other firm in the industry. For example, when one firm cuts prices or offers incentives to increase sales, the others usually protect sales by doing the same. Likewise, when one firm raises prices, others generally follow suit. Therefore, the prices of comparable products are usually similar. When an airline announces new fare discounts, others adopt the same strategy almost immediately. Just as quickly, when discounts end for one airline, they usually end for everyone else.

MONOPOLY 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 producer 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.

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

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

Economic Indicators

Because economic forces are so volatile and can be affected by so many things, 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 fortunes (as was the case during 2009–2010). At still other times, it provides moderate growth, helping some members of society but not others (as is the case at present). Clearly, then, knowing how an economy is performing is useful for business owners and investors alike. Most experts look to various **economic indicators**—statistics that show whether an economic system is strengthening, weakening, or remaining stable—to help assess the performance of an economy.

OBJECTIVE 1-4

Explain the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.

Economic Indicators statistics that help assess the performance of an economy

Economic Growth, Aggregate Output, and Standard of Living

At one time, about half the U.S. population was involved in producing the food the country needed. Today, however, only about 1.3 percent of the U.S. population is involved in direct on-farm work.⁸ But agricultural efficiency has actually improved because the industry has devised better ways of producing products with more efficient technology. We can therefore say that agricultural productivity has increased because we have been able to increase total output in the agricultural sector while decreasing the labor needed to produce that output.

We can apply the same concepts to a nation's economic system, although the computations are more complex. Fundamentally, how do we know whether an economic system is growing or not? 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**, the total quantity of goods and services produced by an economic system during a given period.⁹

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:

- 1 Output per capita—the quantity of goods and services per person—goes up.
- 2 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. To know how much your standard of living is improving, you need to know how much your nation's economic system is growing (see Table 1.2).¹⁰ For instance, although the U.S. economy reflects overall growth in most years, in 2009 the economy actually shrank by 2.6 percent due to the recession.

Business Cycle *short-term pattern of economic expansions and contractions*

Aggregate Output *the total quantity of goods and services produced by an economic system during a given period*

Standard of Living *the total quantity and quality of goods and services people can purchase with the currency used in their economic system*

Gross Domestic Product (GDP) *total value of all goods and services produced within a given period by a national economy through domestic factors of production*

Gross National Product (GNP) *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*

Gross Domestic Product **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 aggregate output. Generally speaking, if GDP is going up, aggregate output is going up; if aggregate output is going up, the nation is experiencing *economic growth*.

Sometimes, economists also measure **gross national product (GNP)**, which 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. 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). Calculations quickly become complex because of different factors of production. The labor, for example, will be mostly Brazilian but the capital mostly American. Thus, wages paid to Brazilian workers are part of Brazil's GNP even though profits are not.

REAL GROWTH RATE GDP and GNP usually differ by less than 1 percent, but economists argue that GDP is a more accurate indicator of domestic economic performance because it focuses only on domestic factors of production. With that in mind,

table 1.2 U.S. GDP and GDP per Capita

2019 GDP (\$ Trillion)	2019 GDP: Real Growth Rate (%)	2019 GDP per Capita: Purchasing Power Parity
\$18.64	2.9%	\$57,226

GDP (gross domestic product)

let's look at the middle column in Table 1.2. Here, we find that the real growth rate of U.S. GDP—the growth rate of GDP *adjusted for inflation and changes in the value of the country's currency*—was 2.9 percent in 2019. But what does this number actually mean? Remember that *growth depends on output increasing at a faster rate than population*. The U.S. population is growing at a rate of 0.60 percent per year.¹¹ The *real growth rate* of the U.S. economic system, therefore, has been modest since 2011.

GDP PER CAPITA The number in the third column of Table 1.2 is a reflection of the standard of living: **GDP per capita** means GDP per individual person. We get this figure by dividing total GDP (\$18.64 trillion) by total population, which happens to be a bit over about 327 million.¹² In a given period (usually calculated on an annual basis), the United States produces goods and services equal in value to \$57,226 for every person in the country. Figure 1.3 shows both GDP and GDP per capita in the United States between 1950 and 2019. GDP per capita is a better measure than GDP itself of the economic well-being of the average person.

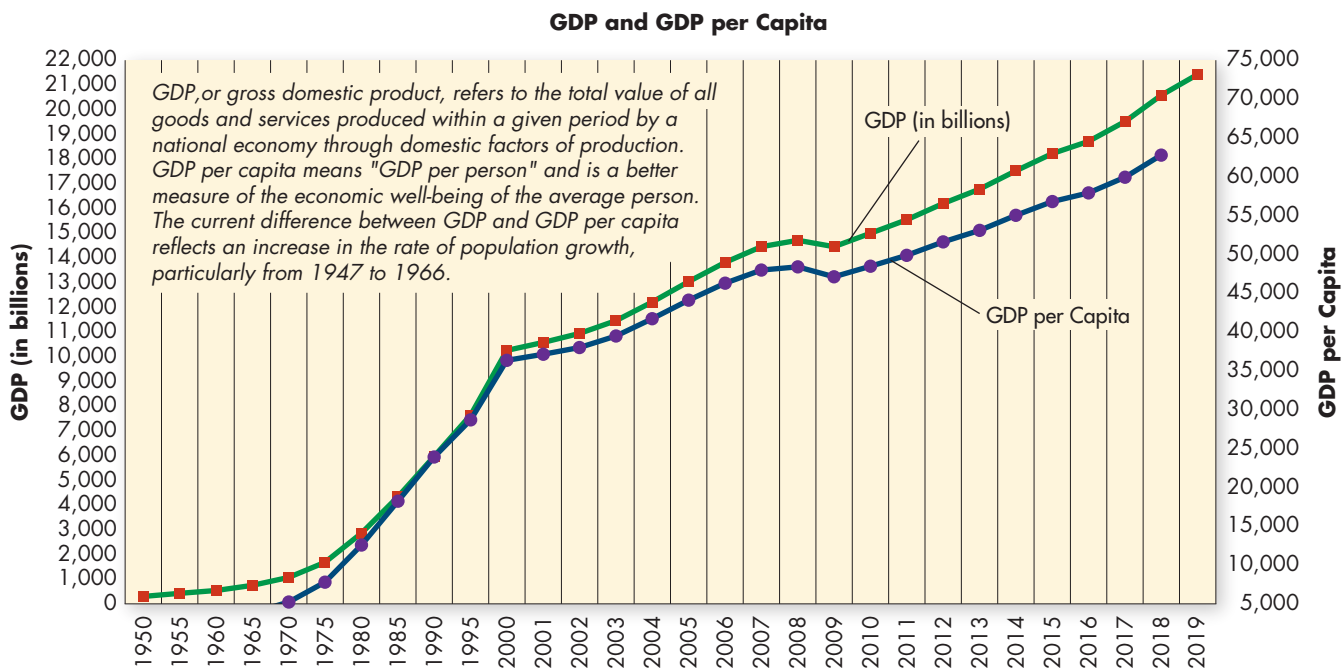
GDP per Capita *gross domestic product divided by total population*

REAL GDP **Real GDP** means that GDP has been adjusted to account for changes in currency values and price changes. To understand why adjustments are necessary, assume that pizza is the only product in a hypothetical economy. In 2020, a pizza cost \$10; in 2021, a pizza cost \$11. In both years, exactly 1,000 pizzas were produced. In 2020, the local GDP was \$10,000 (\$10 × 1,000); in 2021, the local GDP was \$11,000 (\$11 × 1,000). Has the economy grown? No. Because 1,000 pizzas were produced in both years, *aggregate output* remained the same. The point is to not be misled into believing that an economy is doing better than it is. If it is not adjusted, local GDP for 2021 is **nominal GDP**—GDP measured in current dollars or with all components valued at current prices.¹³

Real GDP *GDP adjusted to account for changes in currency values and price changes*

PURCHASING POWER PARITY In the example, *current prices* would be 2021 prices. In contrast, 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

Nominal GDP *GDP measured in current dollars or with all components valued at current prices*



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

FIGURE 1.3 GDP and GDP per Capita

Sources: Based on <https://www.bea.gov/data/gdp> and <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=US>

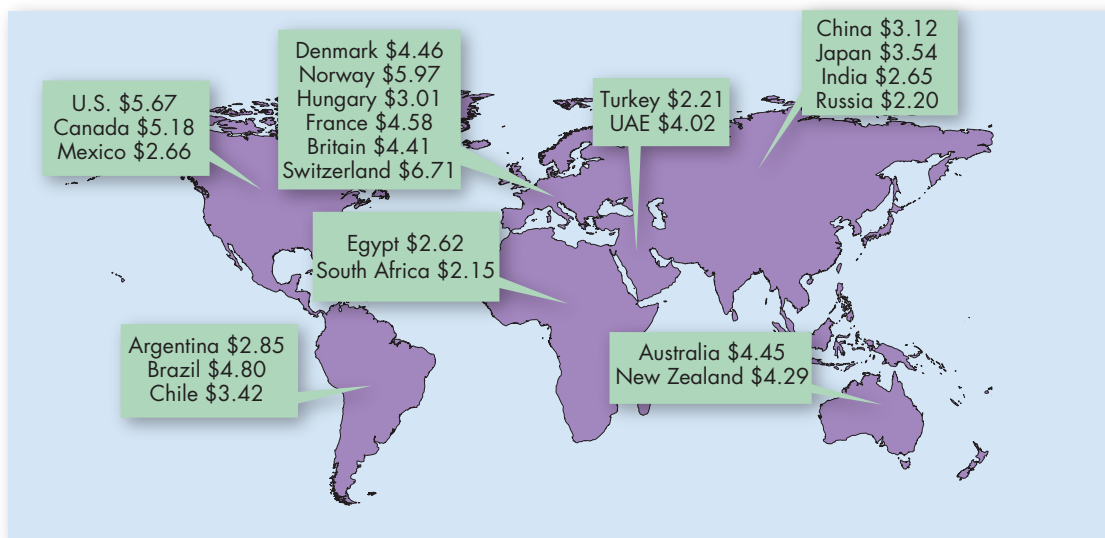


FIGURE 1.4 Price of a Big Mac in U.S. Currency in January 2020
 Source: Based on The Big Mac Index. Published by the Economist website. <https://www.economist.com/news/2020/01/15/the-big-mac-index>

Purchasing Power Parity *the principle that exchange rates are set so that the prices of similar products in different countries are about the same*

GDP and **purchasing power parity**, 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*. In other words, it gives us a better sense of standards of living across the globe. Figure 1.4 illustrates a popular approach to see how purchasing power parity works in relation to a Big Mac. For instance, the figure pegs the price of a Big Mac in the United States at \$5.67. Based on currency exchange rates, a Big Mac would cost \$6.71 in Switzerland and \$5.97 in Norway. But the same burger would cost only \$3.12 in China and \$2.65 in India.

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

Productivity A major factor in the growth of an economic system is **productivity**, which is a measure of economic performance 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 German workers and the equivalent of 1.5 dollars in euros, the currency of Germany, 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 German soccer-ball industry. The two factors of production in this extremely simple case are labor and capital.

If more products are being produced with fewer factors of production, the prices of these products will likely go down. As a consumer, therefore, you would need less of your currency to purchase the same quantity of these products. In short, your standard of living—at least with regard to these products—has improved. If your entire economic system increases its productivity, then your overall standard of living improves. In fact, standard of living improves *only* through increases in productivity.¹⁴ Real growth in GDP reflects growth in productivity.

Productivity in the United States is generally increasing, and as a result, so are GDP and GDP per capita in most years (excluding the 2009 recession). Ultimately, increases in these measures of growth mean an improvement in the standard of living. However, things don’t always proceed so smoothly. Several factors can inhibit the growth of an economic system, including *balance of trade* and the *national debt*.

Balance of Trade *economic value of all products a country exports minus the economic value of all products it imports*

BALANCE OF TRADE A country’s **balance of trade** is the economic value of all the products that it exports minus the economic value of its imported products. The principle here is quite simple:

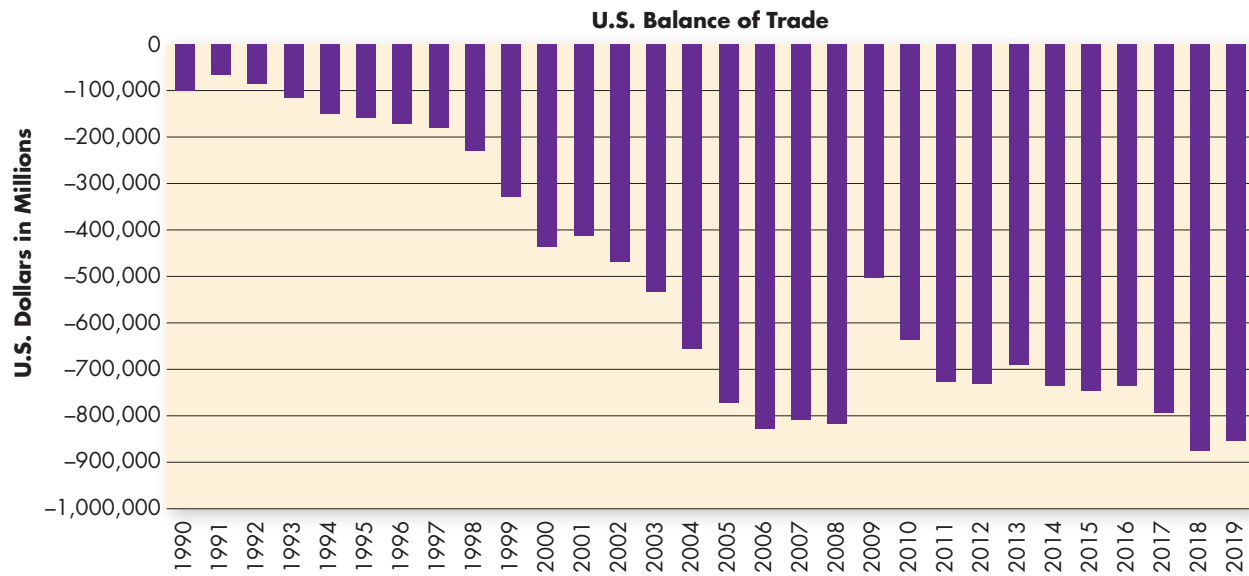


FIGURE 1.5 U.S. Balance of Trade

Source: <https://www.census.gov/foreign-trade/balance/c0004.html> (2020)

- 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.

A negative balance of trade is commonly called a *trade deficit*. In 2019, the U.S. trade deficit was about \$850 billion. The United States is a *debtor nation* rather than a *creditor nation*. Recent trends in the U.S. balance of trade are shown in Figure 1.5.

Trade deficit affects economic growth because the amount of money spent on foreign products has not been paid in full. Therefore, it is, in effect, borrowed money, and borrowed money costs more in the form of interest. The money that flows out of the country to pay off the deficit can't be used to invest in productive enterprises, either at home or overseas.

NATIONAL DEBT Its **national debt** is the amount of money that the government owes its creditors. As of this writing, the U.S. national debt is around \$21.6 trillion, or about \$65,600 per U.S. citizen, and is increasing at a rate of around \$2 billion per day. You can find out the national debt on any given day by going to any one of several Internet sources, including the U.S. National Debt Clock at <https://www.pgpf.org/national-debt-clock>.

National Debt *the amount of money the government owes its creditors*

How does the national debt affect economic growth? Although taxes are the most obvious way the government raises money, it also sells *bonds*—securities through which it promises to pay buyers certain amounts of money by specified future dates. (In a sense, a bond is an IOU with interest.¹⁵) These bonds are attractive investments because they are extremely safe: The U.S. government is not going to default on them (that is, fail to make payments when due). Even so, they must also offer a decent return on the buyer's investment, and they do this by paying interest at a competitive rate. By selling bonds, therefore, the U.S. government competes with every other potential borrower for the available supply of loanable money. The more money the government borrows, the less money is available for the private borrowing and investment that increase productivity.

Economic Stability

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.

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

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, when people compete with one another to buy available products, prices go up. These 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.

Consumer Price Index (CPI) a measure of the prices of typical products purchased by consumers living in urban areas

Keeping in mind that our definition of inflation is the occurrence of widespread price increases throughout an economic system, it stands to reason that we can measure inflation by measuring price increases. Price indexes such as the **consumer price index (CPI)** measure the prices of typical products purchased by consumers living in urban areas.¹⁶ The CPI is expressed as a percentage of prices as compared to a base period. The current base period used to measure inflation is 1982–1984, which is set at 100 (indicating a percentage). For comparison purposes, the CPI index was 172.2 in 2000, 195.3 in 2005, 218.1 in 2010, 229.6 in 2012, 240.7 in 2016, and 256.6 in 2019. So, prices in 2010 reached more than double the level in the 1982–1984 base period. At the same time, though, the CPI also shows us that inflation has decreased in recent years.

Although we tend to view inflation as bad, in most ways it is better than *deflation*, which happens when widespread price cuts occur. Whereas inflation creates instability, it also generally indicates the overall economy is growing (just in an erratic manner). But deflation generally means the overall economy is shrinking, a more serious problem from most perspectives.

Unemployment the level of joblessness among people actively seeking work in an economic system

Unemployment Finally, we need to consider the effect of unemployment on economic stability. **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 reduce 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.

At least two problems are related to unemployment:

- 1 If wage rates get too high, businesses will respond by hiring fewer workers and unemployment will go up.
- 2 Businesses could raise prices to counter increased labor costs, but they won't be able to sell as many of their products at higher prices. Because of reduced sales, they will cut back on hiring and, once again, unemployment will go up.

What if the government tries to correct this situation by injecting more money into the economic system—say, by cutting taxes or spending more money? Prices in general may go up because of increased consumer demand. Again, purchasing power declines and inflation may set in.¹⁷ During the recession of 2009 and its aftermath, millions of workers lost their jobs as businesses such as Circuit City closed their doors and others, such as General Motors and Kodak, cut thousands of jobs in an effort to stem losses. Indeed, in early 2010, unemployment in the United States reached a 25-year high of 10.2 percent. By November 2011, as the economy was gradually pulling out of recession, unemployment had dropped to around 8.7 percent, and by November 2012, official unemployment was 7.7 percent. By the end of 2016, it had dropped even further, to 4.9 percent.¹⁸ In early 2020, unemployment had continued to decline and was hovering around 3.5 percent.¹⁹ By mid-2020, however, the impact of COVID-19 had pushed unemployment up to over 8 percent.

RECESSIONS AND DEPRESSIONS Unemployment is sometimes a symptom of a system-wide disorder in the economy. During a downturn in the business cycle, people in different sectors may lose their jobs at the same time. As a result, overall income and spending may drop. Feeling the pinch of reduced revenues, businesses

managing in turbulent times

Coronavirus: The Global Economic Impact of Disease

In 430 BC, Athenians were beaten as much by a plague as they were by the Spartans. In AD 165, the Roman army was devastated by smallpox. In AD 541, the bubonic plague killed half the population of Europe, and in the 14th century, the Black Death altered the course of human history. As people became more mobile, rats and fleas carried the bubonic plague farther than ever before, decimating the population, depressing the global economy, and shifting the remaining workforce away from feudalism and labor-intensive crops toward capitalism and innovation.

In 1918, an avian-borne flu infected over a third of the world's population and took the lives of 50 million people. But unlike previously recorded pandemics that tended to target those with weaker immune systems, the "Spanish Flu" was most deadly for people between the ages of 20 and 40, which meant that it killed a large percentage of the world's workforce. In 1957, the world faced an outbreak of Asian flu, and by 1981, HIV/AIDS was ravaging a previously healthy population. Each of these public health crises, in addition to the horrific loss of human life, had both micro- and macroeconomic consequences.

More recently, severe acute respiratory syndrome (SARS), which struck in 2003, affected corporate profits as business and leisure travelers drastically cut back on flying. Airlines, cruise ships, and hotels saw significant declines in revenue as tourists hunkered down rather than risk infection while

traveling. It even cut deeply into the bottom line for Estee Lauder, which sells a significant amount of cosmetics in Hong Kong, in Singapore and China, and in duty-free airport shops.

In addition to these outbreaks, we've experienced Middle East respiratory syndrome (MERS), swine flu, and many other epidemics that have affected global commerce. Each crisis has shown us that a direct impact on the economy results as more and more of the workforce stays home but that an indirect impact occurs as well. Income falls when people don't work for several weeks, and, in turn, those same people curtail spending; the people who don't receive that spending cut their own in turn. Although the actual impact on gross domestic product is hard to determine, there are definite effects on financial markets (Figure 1.6). In addition, the decrease in the supply of some goods as factories run at less than full capacity might lead to shortages, and that, in turn, could lead to high inflation. In some specific circumstances, such as the manufacture of virus-filtering face masks, even with robust production, suppliers can't meet demand, and market forces drive prices upward, sometimes outrageously.

Most recently, the COVID-19 pandemic, which emerged in December 2019, sent a shock wave through the world markets as investors lost confidence in the economy and share prices across the board tumbled. It is important for the entrepreneur or manager of a business to keep these kinds of potential external calamities in mind and to work them into contingency plans.

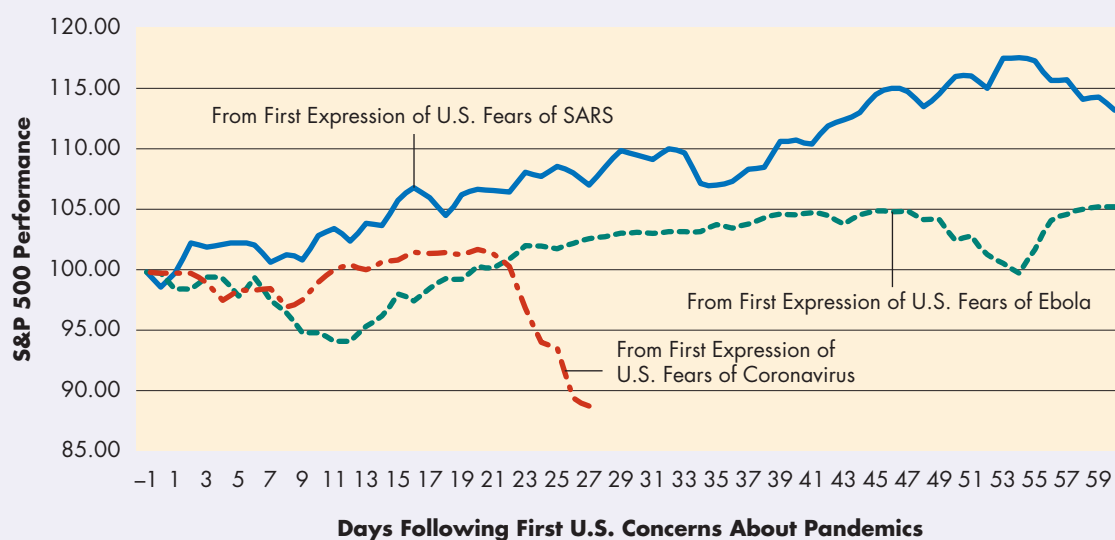


FIGURE 1.6 S&P Performance Over First 60 Trading Days Following First U.S. Concerns Regarding SARS (2003), EBOLA (2014) and COVID-19 (2020) Outbreaks (Day-1=100)

Source: Business Insider/Insider, Inc. <https://www.businessinsider.com/stock-market-sell-off-drop-coronavirusvaluations-start-2020-2>

may cut spending on the factors of production—including labor. Yet more people will be put out of work, and unemployment will only increase further. Unemployment that results from this trend is called *cyclical unemployment*.

If we look at the relationship between unemployment and economic stability, we are reminded that when prices get high enough, consumer demand for goods and services goes down. We are also reminded that when demand for products goes down, producers cut back on hiring and, not surprisingly, eventually start producing less. Consequently, aggregate output decreases. When we go through a period during which aggregate output declines, we have a recession. During a *recession*, producers need fewer employees—less labor—to produce products. Unemployment, therefore, goes up.

To determine whether an economy is going through a recession, we start by measuring aggregate output. Recall that this is the function of real GDP, which we find by making necessary adjustments to the total value of all goods and services produced within a given period by a national economy through domestic factors of production. A **recession** is more precisely defined as a period during which aggregate output, as measured by real GDP, declines. As noted previously, most economists agree that the U.S. economy went into recession in 2008; most also agree that we were gradually emerging from that recession in 2011. A prolonged and deep recession is 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. However, it has come to be popularly known as the Great Recession, and we will use this phrase in this book.

Recession a period during which aggregate output, as measured by GDP, declines

Depression a prolonged and deep recession

Managing the U.S. Economy

The government acts to manage the U.S. economic system through two sets of policies: fiscal and monetary. It 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. One key element of President Obama’s presidential platform was an overhaul of the U.S. tax system. Among other things, he proposed cutting taxes for the middle class while simultaneously raising taxes for both higher-income people and businesses. During President Trump’s presidency he initiated efforts to lower all taxes, although higher-income people and businesses saw the largest cuts. For a variety of reasons, however, little ever gets accomplished in the area of comprehensive tax reform.

Fiscal Policies policies used by a government regarding how it collects and spends revenue

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. For example, to help combat the Great Recession, the government injected more money into the economy through various stimulus packages. On the one hand, officials hoped that these funds would stimulate business growth and the creation of new jobs. On the other hand, though, some experts feared that increasing the money supply might also lead to inflation. In reality, inflation did go up but not by a large amount. A more recent example of the use of monetary policy took place during the 2020 COVID-19 pandemic. As economic activity ground to a halt, the Fed lowered interest rates to incentivize banks to continue to loan money.

Monetary Policies policies used by a government to control the size of its money supply

Taken together, fiscal policy and monetary policy make up **stabilization policy**, government economic policy in which the goal is to smooth out fluctuations in output and unemployment and to stabilize prices. In effect, the Great Recession 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.

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

Developing Skills in Your Career

OBJECTIVE 1-5

Learn about the skills you will gain through this text.

If you haven't yet decided on a major, you may be thinking that this section isn't relevant to you. Let me assure you it is. Whether or not you plan on a career in business, the lessons you learn in this course will help you (in business or life or both). Moreover, it is only through the aggregate of your educational experience that you will have the opportunity to develop many of the skills that employers have identified as critical to success in the workplace. In this course, and specifically in this text, you'll have the opportunity to develop and practice these skills in the following places:

Communication Communication is covered in several places throughout the book. For example, Chapter 5 discusses how leaders communicate the corporate culture, while Chapter 6 discusses how managers communicate the delegation process and how managers can use communication to offset errors in the grapevine.

Critical Thinking Chapter 9 devotes specific attention to the decision-making process. Chapter 11 discusses the research process and research methods.

Collaboration Teams and team-based methods of organizing are discussed in Chapters 6 and 8. At the end of each chapter, there is also a continuing team exercise.

Business Ethics and Social Responsibility Chapter 2 is entirely devoted to ethics and social responsibility.

Information Technology Application and Computing Skills Chapter 14 is devoted to information technology application and computing skills for business.

summary of learning objectives

OBJECTIVE 1-1

Define the nature of global business, describe the external environments of business, and discuss how these environments affect the success or failure of organizations.

A *business* is an organization that sells goods or services to earn profits. The prospect of earning *profits*, the difference between a business's revenues and expenses, encourages people to open and expand businesses. Businesses produce most of the goods and services that Americans consume and employ most working people. A healthy business environment supports innovation and contributes to the quality of life and standard of living of people in a society.

The *external environment* of business refers to everything outside its boundaries that might affect it. Both the *domestic* and the *global business environment* affect virtually all businesses. The domestic business environment is the environment in which a business conducts its operations and derives its revenues. The global business environment also refers to the international forces that affect a business, for example, international trade agreements, economic conditions, and political unrest.

The *technological*, *political-legal*, *sociocultural*, and *economic environments* are also important. The technological environment includes all the ways by which firms create value for their constituents. Technology includes human knowledge, work methods, physical equipment,

electronics, telecommunications, and various processing systems that are used to perform business functions. The political-legal environment reflects the relationship between business and government, usually in the form of government regulation of business. The sociocultural environment includes the customs, mores, values, and demographic characteristics of the society in which an organization functions. Sociocultural processes also determine the goods and services that a society is likely to value and accept. The economic environment refers to the relevant conditions that exist in the economic system in which an organization functions.

OBJECTIVE 1-2

Describe the different types of global economic systems according to the means by which they control the factors of production.

Economic systems differ in the ways in which they manage the five *factors of production*: (1) *labor*, or *human resources*; (2) *capital*; (3) *entrepreneurship*; (4) *physical resources*; and (5) *information resources*. Labor, or human resources, includes the physical and intellectual contributions people make while engaged in business. Capital includes all financial resources needed to operate a business. Entrepreneurs are an essential factor of production. They are the people who accept the risks and opportunities associated with creating and operating businesses. Virtually every business will rely on physical resources, the tangible things organizations use to conduct their business. Physical resources include raw materials, storage and production facilities, computers, and equipment. Finally, information resources are essential to the success of a business enterprise. Information resources include data and other information used by business.

Economic systems can be differentiated based on the way they allocate the factors of production. A *planned economy* relies on a centralized government to control factors of production and make decisions. Under *communism*, the government owns and operates all sources of production. In a *market economy*, individuals—producers and consumers—control production and allocation decisions through supply and demand. A *market* is a mechanism for exchange between the buyers and sellers of a particular product or service. Sellers can charge what they want, and customers can buy what they choose. The political basis of market processes is *capitalism*, which fosters private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive. Most countries rely on some form of *mixed market economy*—a system featuring characteristics of both planned and market economies. *Socialism* may be considered a planned economy or a mixed economy, with government ownership of selected industries but considerable private ownership, especially among small businesses.

OBJECTIVE 1-3

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.

Decisions about what to buy and what to sell are determined by the forces of demand and supply. *Demand* is the willingness and ability of buyers to purchase a product or service. *Supply* is the willingness and ability of producers to offer a product or service for sale. A *demand and supply schedule* reveals the relationships among different levels of demand and supply at different price levels. The point at which the demand and supply curves intersect is called the market or equilibrium price. If a seller attempts to sell above the market price, he or she will have a surplus where the quantity supplied exceeds the demand at that price. Conversely, a shortage occurs when a product is sold below the equilibrium price and demand outstrips supply.

Market economies reflect the operation of a *private enterprise system*, a system that allows individuals to pursue their own interests without government restriction. Private enterprise requires the presence of four elements: (1) private property rights, (2) freedom of choice, (3) profits, and (4) competition. Economists have identified four degrees of competition in a private enterprise system: (1) *perfect competition*, (2) *monopolistic competition*, (3) *oligopoly*, and (4) *monopoly*. Perfect competition exists when all firms in an industry are small, there exist many of them, and no single firm is powerful enough to influence prices. In monopolistic competition,

numerous sellers try to differentiate their product from that of the other firms. An oligopoly exists when an industry has only a few sellers. It is usually quite difficult to enter the market in an oligopoly, and the firms tend to be large. A monopoly exists when there is only one seller in a market. A firm operating in a monopoly has complete control over the price of its products.

OBJECTIVE 1-4

Explain the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.

Economic indicators are statistics that show whether an economic system is strengthening, weakening, or remaining stable. The overall health of the economic environment—the economic system in which businesses operate—affects organizations. The two key goals of the U.S. system are *economic growth* and *economic stability*. Growth is assessed by *aggregate output*, the total quantity of goods and services produced by an economic system. Although gains in productivity can create growth, the *balance of trade* and the *national debt* can inhibit growth. While growth is an important goal, some countries may pursue economic stability. *Economic stability* means that 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. The two key threats to stability are *inflation* and *unemployment*. The government manages the economy through two sets of policies: *fiscal policies* (such as tax increases) and *monetary policies* that focus on controlling the size of the nation's money supply.

OBJECTIVE 1-5

Learn about the skills you will gain through this text.

Individuals need a variety of skills to succeed in their careers. This book will help you develop and enhance your skills in the areas of communication, critical thinking, collaboration, business ethics and social responsibility, and information technology and computer applications.

key terms

- aggregate output (p. 46)
- balance of trade (p. 48)
- business (p. 32)
- business cycle (p. 46)
- capital (p. 37)
- capitalism (p. 40)
- communism (p. 38)
- competition (p. 43)
- consumer price index (CPI) (p. 50)
- demand (p. 41)
- demand and supply schedule (p. 41)
- demand curve (p. 42)
- depression (p. 52)
- domestic business environment (p. 33)
- economic environment (p. 35)
- economic indicators (p. 45)
- economic system (p. 36)
- entrepreneur (p. 37)
- external environment (p. 33)
- factors of production (p. 36)
- fiscal policies (p. 52)
- global business environment (p. 34)
- gross domestic product (GDP) (p. 46)
- GDP per capita (p. 47)
- gross national product (GNP) (p. 46)
- inflation (p. 50)
- information resources (p. 38)
- labor (human resources) (p. 37)
- law of demand (p. 41)
- law of supply (p. 41)
- market (p. 38)
- market economy (p. 38)
- market price (equilibrium price) (p. 42)
- mixed market economy (p. 40)
- monetary policies (p. 52)
- monopolistic competition (p. 44)
- monopoly (p. 45)
- national debt (p. 49)
- natural monopoly (p. 45)
- nominal GDP (p. 47)
- oligopoly (p. 45)
- perfect competition (p. 44)
- physical resources (p. 37)
- planned economy (p. 38)
- political-legal environment (p. 35)
- private enterprise (p. 43)
- privatization (p. 40)
- productivity (p. 48)
- profits (p. 32)
- purchasing power parity (p. 48)
- real GDP (p. 47)
- recession (p. 52)
- shortage (p. 43)
- socialism (p. 40)
- sociocultural environment (p. 35)
- stability (p. 49)
- stabilization policy (p. 52)
- standard of living (p. 46)
- supply (p. 41)
- supply curve (p. 42)
- surplus (p. 43)
- technological environment (p. 35)
- unemployment (p. 50)

questions & exercises

QUESTIONS FOR REVIEW

- 1-1. Enterprising people can spot promising opportunities. What do they need to do then?
- 1-2. Labor is usually referred to as human resources. Aside from physical work, what else does this include?
- 1-3. What are the laws of demand and supply?
- 1-4. When output grows more quickly than population, what usually follows?

QUESTIONS FOR ANALYSIS

- 1-5. Identify and describe the features of a domestic environment. Why is it important to a business organization?
- 1-6. Give an example of a monopoly. Under what business circumstances would monopolies be preferable to the presence of competition?
- 1-7. Using your country as an example, explain how the balance of trade and national debt have a direct impact on the finances or growth of a country's economy.

- 1-8. What does the balance of trade tell you about a country's ability to produce goods and services that can be consumed by the domestic market?

APPLICATION EXERCISES

- 1-9. Identify businesses or industries in your country that demonstrate the characteristics of perfect competition, monopolistic competition, oligopoly, and monopoly. To what extent does the government get involved in regulating aspects of the economy and ensuring that there is sufficient competition across the sectors? What more could they do in order to ensure varied and healthy levels of competition?
- 1-10. Interview a business owner or senior manager. Ask this individual to describe the following things: (1) how broad the competition is in the market in which they operate, (2) what the relative strength of the key competitors is, and (3) how they would rank their own company in terms of competitive strength.

building a business: continuing team exercise

Build a team of three to five classmates. You will be working with this team throughout the semester to make decisions about the launch of a new product.

ASSIGNMENT

Meet with your team members and develop specific responses to the following:

- 1-11. Have each team member work individually to identify at least three trends in the external environment that will create business opportunities. Come together as a group and create a master list of trends.

- 1-12. Which trend does the group think creates the greatest opportunity for success? Why?
- 1-13. Identify a product, either a good or a service, that will take advantage of this opportunity. Although you will refine this throughout the semester, write a four- to six-sentence description of your product and how it will spark buyer interest.
- 1-14. Who is your competition for this product, either by direct competition or by substitute products? Is competition a good sign for your business?

team exercise

TOO MANY CHOICES

Background Information

Assume that you are the owner of a busy sandwich bar at a university campus. There are four other concessions in the central hub where your kiosk is located. The normal price for a sandwich and a large drink is \$10. The other concessions offer similar options from \$9.5 to \$12. You have just read a flyer distributed by one of the other concessions announcing that they are launching a customer loyalty program: if customers collect

four stickers in a given week, their fifth meal will be free. You note that the concession is advertising their lunch packages for \$12.50. This means that one of their regular customers will net them \$50 per week. This is exactly the same as your pricing across a five-day week. The problem for you is that the loyalty program will lock in potential customers.

Team Activity

Assemble a group of four or five people. Each group should develop a general strategy for responding to the competitors'

price and promotional changes. Be sure to consider the following factors:

- How price changes affect the demand for your product
- The number of competitors selling the same or a similar product
- The methods you can use—other than price—to attract new customers and retain current customers

FOLLOW-UP QUESTIONS

1-15. What form of competition best characterizes this market?

1-16. Develop specific pricing strategies based on each of the following situations:

- A month after introducing the promotion, the competitor increases their daily average price to \$13.50.

- Two of the other concessions launch a joint venture promotion offering the same deal as the competitor; customers can collect stamps from either concession to claim a free meal.
- The fourth concession drops their lunch menu average price to \$8.50.
- After two months, the fourth concession closes; there are rumors that a national chain is interested in the concession.
- All five concessions, including you, are noticing that sales are down. You discover that someone has set up a street-food mobile canteen outside the campus.

1-17. Discuss the role that various promotions other than price might play in affecting demand and supply in this market.

1-18. How can a company compete on a non-price basis and still retain or grow market share?

exercising your ethics

EMPTY STORE

The Situation

You are the owner of a retail store in a small town. The store has been owned by your family for three generations. Originally, your great grandfather sold fruit and vegetables from the premises, but after he died, the store has been leased or rented out to a succession of small business owners. Given the location of the store, none of the businesses has lasted for more than about five years.

The Dilemma

The last tenant of the store closed down nearly eighteen months ago with their rental payments in arrears. They disappeared overnight and left the building in a very bad state of repair. It has already cost you a considerable amount of money (roughly half the sum you would have received for a year's rent) to repair the shop. You are paying taxes on the store, and it has suffered three break-ins over the past four months; piping was stolen, and a fire was started in the storeroom.

You have tried to find a suitable tenant for the property, but so far, you have failed. Several other stores in the immediate area are also empty. You have dropped your rental charges by 20 percent to attract tenants, but no one is interested so far. The property is not really suitable for conversion to domestic use either.

You have been approached by a charity that wants to run a drop-in clinic in the store. They cannot afford to pay rent, but they have promised to ensure that the property is not damaged. There will be staff on the premises 24 hours a day, so break-ins are unlikely.

You need to decide whether to give the charity a short-term six-month free lease.

QUESTIONS TO ADDRESS

- 1-19. What are the roles of supply and demand in this scenario?
- 1-20. What are the underlying ethical issues?
- 1-21. What would you do if you were actually faced with this situation?

cases

BIG ON QUALITY, LIDL ON PRICE

Continued from page 30

At the beginning of this chapter, you read about Lidl Stiftung & Co. KG. Using the information presented in this chapter, you should now be able to answer these questions.

QUESTIONS FOR DISCUSSION

1-22. Name the different factors of the domestic and international business environment that have affected Lidl's operations and growth.

1-23. Throughout Lidl's domestic and international history, economic factors have been key to its growth. Identify these factors and explain how they have shaped Lidl's operations at home and abroad.

1-24. How did Lidl try to distinguish itself from its main competitors in the domestic market (Germany) and in the international one (United Kingdom)? Why did the strategies adopted in the two markets differ?

1-25. The COVID-19 pandemic presented a clear advantage to retailers with developed online shopping capabilities. Why did Lidl's lack of online presence not result in its

complete failure after the pandemic? Do you think the strategy of in-store-only shopping continues to work for Lidl?

- 1-26. Running a big business such as Lidl is a challenging process. What kind of soft skills would a Managing Director need to operate during a crisis like COVID-19?

GAME THEORY IN THE VIDEO GAME CONSOLE INDUSTRY

Nintendo, Sony, and Microsoft have been going head-to-head in the gaming industry ever since the demise of the Sega Dreamcast in 2000, the last of the old-school game consoles. Over the years, other companies have tried to break into the market. In 2013, entrepreneur Julie Uhrman brought the \$100 list price Ouya game console to market with Kickstarter funds, but with only a few original games and a limited capacity to produce and promote, the company failed and the product was pulled from the market in 2015. As of early 2020, a search for video game consoles pulls up a robust array of choices but still indicates that just three players are in the game.

Video gamers can be militantly loyal to their brand. Sony and Microsoft allocate large amounts of their advertising and promotional budgets to differentiating their products, trying to get users to switch. In that battle, Microsoft tended to focus more on software, and Sony tended to focus more on hardware, but it wasn't until the introduction of the Wii in November 2006 by Nintendo that a game console was actually operationally different. As Nintendo president Reggie Fils-Aimé put it, "Nintendo has a quite appropriate reputation of doing its own

thing, so whatever Microsoft and Sony decide to do, that's for them to manage."²⁰

In a new plot twist, in May 2019, Sony and Microsoft announced that they would be teaming up to work on cloud technologies and artificial intelligence.

QUESTIONS FOR DISCUSSION

- 1-27. In terms of degrees of competition, how would you describe the market for game consoles? Do you think this will change in the next 5 years? If so, how?
- 1-28. How hard would it be for a new company to get started in the game console industry? What are the barriers to entry? What strategies would you suggest for someone with an idea for a new game console?
- 1-29. Do you think that innovations, breakthroughs, and pricing strategies in the game console market are coordinated? Why or why not?
- 1-30. How do you think an alliance between Microsoft and Sony would affect competition in the video game console industry? Do you think it would be beneficial or harmful for consumers? Explain your position.
- 1-31. Do you think that having more manufacturers in this industry would be positive or negative? Why?
- 1-32. Which game console do you think is superior? Give a short list of reasons for your opinion.

endnotes

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- ⁶ See Karl E. Case, Ray C. Fair, and Sharon Oster, *Principles of Economics*, 13th ed., updated (Upper Saddle River, NJ: Prentice Hall, 2017), 103–105.

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- ¹⁰ Central Intelligence Agency, *The World Factbook*, accessed February 20, 2020, <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.
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- ¹² United States Census Bureau, "United States | 2019 Population Estimates," accessed February 20, 2020, <https://www.census.gov/search-results.html?q=us+population+for+2019>.
- ¹³ See Olivier Blanchard, *Macroeconomics*, 8th ed. (Upper Saddle River, NJ: Pearson, 2020), 24–26.
- ¹⁴ See Jay Heizer and Barry Render, *Operations Management*, 12th ed. (Upper Saddle River, NJ: Prentice Hall, 2018).

- ¹⁵ Heyne, Boetke, and Prychitko, *The Economic Way of Thinking*, 491–493.
- ¹⁶ Ronald M. Ayers and Robert A. Collinge, *Economics: Explore and Apply*. (Upper Saddle River, NJ: Prentice Hall, 2004), 163–167.
- ¹⁷ See Heyne, Boetke, and Prychitko, *The Economic Way of Thinking*, 403–409, 503–504.
- ¹⁸ United States Department of Labor, Bureau of Labor Statistics, “Employment Situation Summary,” accessed February 17, 2017, <https://www.bls.gov/news.release/empsit.nr0.htm>.
- ¹⁹ Department of Labor, Bureau of Labor Statistics, “The Employment Situation—March 2020,” accessed February 20, 2020, <https://www.bls.gov/news.release/pdf/empsit.pdf>.

Understanding Business Ethics and Social Responsibility

chapter 2

Lost_in_the_Midwest/Shutterstock



learning objectives

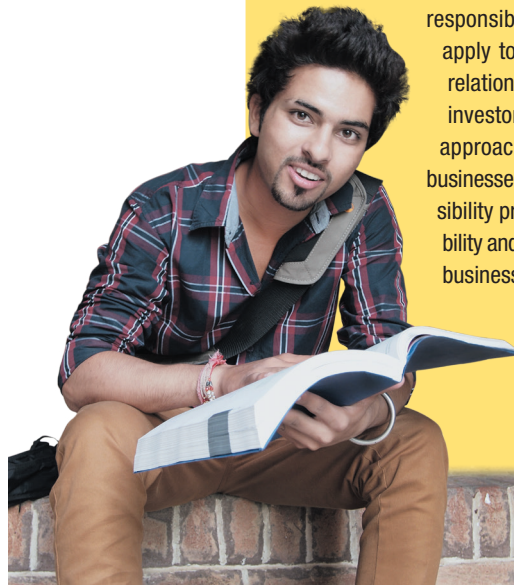
After reading this chapter, you should be able to:

- 2-1 Explain** how individuals develop their personal codes of ethics and why ethics are important in the workplace.
- 2-2 Distinguish** social responsibility from ethics, identify organizational stakeholders, and characterize social consciousness today.
- 2-3 Show** how the concept of social responsibility applies both to environmental issues and to a firm's relationships with customers, employees, and investors.
- 2-4 Identify** four general approaches to social responsibility and note the role of social responsibility in small business.
- 2-5 Explain** the role of government in social responsibility in terms of how governments and businesses influence each other.
- 2-6 Discuss** how businesses manage social responsibility in terms of both formal and informal dimensions and how organizations can evaluate their social responsibility.

what's in it for me?

Business practices today are under more scrutiny than ever before. Business owners and managers are often torn between doing what makes sense for the bottom line (such as increasing profit) versus doing what makes sense for general social welfare. By understanding the material in this chapter, you'll be better able to assess ethical and socially responsible issues facing you as an employee and as a boss or business owner and understand the ethical and socially responsible actions of businesses you deal with as a consumer and as an investor.

In this chapter, we'll look at ethics and social responsibility—what they mean and how they apply to environmental issues and to a firm's relationships with customers, employees, and investors. Along the way, we look at general approaches to social responsibility, the steps businesses must take to implement social responsibility programs, how issues of social responsibility and ethics affect small businesses, and how businesses attempt to manage social responsibility programs. But first, we begin this chapter by discussing ethics in the workplace—individual, business, and managerial.





EpiPen: Balancing Morals and Profits

In a climactic moment in the 1994 film *Pulp Fiction*, Mia Wallace (played by Uma Thurman) overdoses on heroin and hitman Vincent Vega (John Travolta) saves her by stabbing her in the heart with a hypodermic syringe full of adrenaline. It's just a movie, but some science actually backs up the fiction.

Epinephrine, also known as adrenaline, is a hormone best known for its effect on the body in times of danger. In addition to increasing strength and reaction time, epinephrine narrows blood vessels and opens airways in the lungs.

In the 1970s, the U.S. military began equipping soldiers with a self-injecting epinephrine device in the event of chemical warfare, and because of its ability to jump-start the heart and lungs, it's now one of the most common medications in the world.

In 1977, Sheldon Kaplan patented a nonreactive glass cartridge to hold epinephrine, and the self-injecting mechanisms developed for the military came into mainstream use in the 1980s for immediate treatment of anaphylactic shock—an allergic reaction that can shut down airways and blood flow. High demand led to efficiencies in manufacturing, so today, adrenaline is relatively cheap at only a few dollars a vial.

Kaplan sold his idea to Meridian Medical Technologies, which was later bought by pharmaceuticals giant Pfizer, who sold the rights to Merck, who tucked the product line into their generics division. By then the EpiPen, as it is now known, was selling at just under \$100 for a two-pack and, with a 90% market share, represented a virtual monopoly on the emergency allergy rescue market. Even so, it was only generating about \$200 million a year in sales.

Then, in a bold acquisition move in 2007, a relatively small company called Mylan, led by CEO Heather Bresch, bought Merck's generics division for \$6.6 billion, and, in the process, became the owner of the EpiPen brand.

In 2012, Mylan launched a program called EpiPen4Schools to sell EpiPens in bulk and with discounts to schools. To participate in the program, schools had to agree not to buy epinephrine autoinjectors from any other company for a year, and the National Association of State Boards of Education, led by Bresch's mother, Gayle Manchin, launched a policy initiative designed to "help state boards of education as they develop student health policies regarding anaphylaxis and epinephrine auto-injector access and use," and advocated for state laws protecting schools from legal liability for stocking and using epinephrine autoinjectors.

Meanwhile, Mylan lobbyists pushed for Congress to pass a federal law protecting schools from liability for administering epinephrine to a child and providing some financial incentives to encourage schools to stock the EpiPen. In 2013, Congress passed the School Access to Emergency Epinephrine Act and President Barack Obama signed it into law. Bresch's father, Joe Manchin, was a senator at that time and had been instrumental in getting Gayle into her prominent position.

In July 2013, the price for a two-pack of EpiPens had risen from below \$100 to more than \$250. In May 2015 it hit \$460, and by May 2016 the price was in excess of \$600 and was generating more than \$1 billion in annual revenues. Bresch claimed that the price increases were being driven by additional investments in marketing the product, but market forces were also at play—namely, supply and demand, along with a near monopoly on the product. In essence, Mylan was raising prices because they could.

Lost_in_the_Midwest/Shutterstock

But as Mylan reaps the benefits of rising prices, the once barely affordable life-saving device is now out of reach for many people. Other factors are at play here as well: Children can't carry the device, so parents may need to buy multiple sets; the product has a 1-year shelf life; and because of that, most people never actually use the EpiPen before they need to replace it. Insurance companies cover some of the cost, but users still have to pay the deductibles and copays.

Traditional economists argue that pricing is a function of market supply and demand, that a company's duty is to the shareholders, and that duty specifically is to maximize profits. However, the shock of 500% price increases to consumers caused a media storm that resulted in congressional intervention. On September 16, 2016, Mylan CEO Heather Bresch spent the day defending those price increases before the House Oversight and Government Reform Committee.

Since then, although the price of EpiPens hasn't dropped much, Mylan has introduced a generic version of the device, and some competition has managed to infiltrate the once monopolized market. There is, however, a larger issue with drug prices in general. For instance, abiraterone, used to treat metastatic prostate cancer, extends life on average by 4 months—and costs about \$10,000 a month. Pomalidomide (Pomalyst), used to help keep some blood cancers in temporary remission, can cost upward of \$15,000 per month. Congress continues to debate how best to deal with this issue, but there are some overriding concerns about interfering with the free market system.

Meanwhile, Mylan continues to dominate the self-injectable epinephrine market, despite the high cost of a two-pack. Kao-Ping Chua, an assistant professor of pediatrics at the University of Michigan led a study in 2017 that appeared in *JAMA Internal Medicine*. He states it bluntly: "The idea that people could die because they can't afford epinephrine is just morally appalling."¹ (After studying the content in this chapter, you should be able to answer the set of discussion questions found at the end of the chapter.)

Ethics in the Workplace

Just what is ethical behavior? **Ethics** are beliefs about what's right and wrong or good and bad. An individual's values and morals, plus the social context in which his or her behavior occurs, determine whether behavior is regarded as ethical or unethical. In other words, **ethical behavior** is behavior that conforms to individual beliefs and social norms about what's right and good. **Unethical behavior** is behavior that conforms to individual beliefs and social norms about what is defined as wrong and bad. **Business ethics** is a term often used to refer to ethical or unethical behaviors by employees and managers in the context of their jobs.

Individual Ethics

Because ethics are based on both individual beliefs and social context, they vary from person to person, from situation to situation, and from culture to culture. Social standards are broad enough to support differences in beliefs. Without violating general standards, people may develop personal codes of ethics reflecting a wide range of attitudes and beliefs.

Thus, ethical and unethical behaviors are determined partly by the individual and partly by the culture. For instance, virtually everyone would agree that if you see someone drop \$20, the ethical thing to do would be to return it to the owner. But there'll be less agreement if you find \$20 in an empty room but don't know who dropped it. Should you turn it in to the lost-and-found department? Or, because the rightful owner isn't likely to claim it, can you just keep it?

OBJECTIVE 2-1

Explain how individuals develop their personal codes of ethics and why ethics are important in the workplace.

Ethics *beliefs about what is right and wrong or good and bad in actions that affect others*

Ethical Behavior *behavior conforming to generally accepted social norms concerning beneficial and harmful actions*

Unethical Behavior *behavior that does not conform to generally accepted social norms concerning beneficial and harmful actions*

Business Ethics *ethical or unethical behaviors by employees in the context of their jobs*

The Law and the Real World

Societies generally adopt formal laws that reflect prevailing ethical standards or social norms within that society. For example, because most people regard stealing as unethical, we have laws against stealing and ways of punishing those who steal. Those who write laws try to make them as clear and unambiguous as possible, but interpreting and applying them can still lead to ethical ambiguities. Real-world situations can often be interpreted in different ways, and it isn't always easy to apply statutory standards to real-life behavior. For instance, during the aftermath of natural disasters like hurricanes or earthquakes, desperate survivors sometimes break into grocery stores for food and water. These actions are, of course, illegal, but most law enforcement agencies will not press charges because of the circumstances.

Unfortunately, the epidemic of scandals that dominated business news over the past several years shows how willing people can be to take advantage of potentially ambiguous situations—and even create them. For example, Burger King, based in Florida, bought a Canadian fast-food chain and considered moving its corporate offices there simply to take advantage of lower Canadian taxes. Walgreens, headquartered in Illinois, bought a Swiss firm and could also have legally moved its corporate headquarters to Switzerland. However, in the face of adverse publicity and government pressure, both firms reversed course and decided not to relocate.² Similarly, in 2019 some drug manufacturers were criticized when they raised certain drug prices by several hundred percent. A few dropped some of those prices back to their previous levels, but others kept them at higher levels even in the wake of public outrage.³ During the COVID-19 pandemic in 2020, reports surfaced that some wealthy individuals sought to “buy their way” to the front of the line for testing and for when a vaccine became available.⁴

Individual Values and Morals

How should we deal with business situations that are ambiguous in terms of both ethics and the law? No doubt we have to start with the values and morals of people in a business, its managers, employees, and other legal representatives. Each person's individual values and morals help determine a personal code of ethics. Values and morals, in turn, are determined by a combination of factors. As children, we start to form values and morals in response to our perceptions of the behavior of parents and other adults. Soon, we enter school, where we're influenced by peers, and as we grow into adulthood, experience shapes our lives and contributes to our ethical beliefs and our behavior. If you put financial gain at the top of your priority list, you may develop a code of ethics that supports the pursuit of material comfort. If you set family and friends as a priority, you'll no doubt adopt different standards.

Business and Managerial Ethics

Managerial Ethics *standards of behavior that guide individual managers in their work*

Managerial ethics are the standards of behavior that guide individual managers in their work.⁵ Although your ethics can affect your work in any number of ways, it's helpful to classify them in terms of three broad categories.

Behavior Toward Employees This category of managerial ethics relates to such matters as hiring and firing, wages and working conditions, and privacy and respect. Ethical guidelines suggest and legal standards require that hiring and firing decisions should be based solely on a person's ability to perform a job. A manager who discriminates against people of color or women in hiring exhibits both unethical and illegal behavior. But what about the manager who hires a friend or relative who is qualified for the job when someone else might be equally qualified? Or slightly more qualified? Although such decisions may not be illegal, they may be questionable on ethical grounds.

Wages and working conditions, although regulated by law, are also areas for potential controversy. A manager may pay a worker less than he or she deserves, for example, because the manager knows that the employee can't afford to quit or risk

losing the job by complaining. While it is hard to judge whether some cases are clearly ethical or unethical, others are fairly clear cut. Consider the behavior of Enron management toward company employees. Enron management encouraged employees to invest retirement funds in company stock and then, when financial problems began to surface, refused to permit them to sell the stock (even though top officials were allowed to sell). Ultimately, the firm's demise caused thousands of employees to lose their jobs and much of their pension savings.

Behavior Toward the Organization Ethical issues can also arise from employee behavior toward employers, especially in such areas as conflict of interest, confidentiality, and honesty. A *conflict of interest* occurs when an activity may benefit the individual, but to the detriment of his or her employer. Most companies have policies that forbid buyers from accepting gifts from suppliers, for instance, because such gifts might be construed as a bribe or an attempt to induce favoritism. Businesses in highly competitive industries—software and fashion apparel, for example—have safeguards against designers selling company secrets to competitors.

Relatively common problems in the general area of honesty include stealing supplies, padding expense accounts, calling in sick just to stay home and relax, and using a business phone to make personal, long-distance calls.⁶ Most employees are honest, but many organizations remain vigilant. Again, Enron is a good example of employees' unethical behavior toward an organization; top managers not only misused corporate assets but also often committed the company to risky ventures to further their own personal interests.

Behavior Toward Other Economic Agents Ethics also come into play in the relationship of a business and its employees with so-called *primary agents of interest*, mainly customers, competitors, stockholders, suppliers, dealers, and unions. In dealing with such agents, there is room for ethical ambiguity in just about every activity—advertising, financial disclosure, ordering and purchasing, bargaining and negotiation, and other business relationships. Bernard Madoff's investment scams cost hundreds of his clients their life savings. He led them to believe their money was safe and that they were earning large returns when in fact their money was being hidden and used to support his own extravagant lifestyle. He then used funds from new clients to pay returns to older clients (this is called a *Ponzi scheme*). Madoff's actions showed a blatant disregard for his investors. But Madoff was not the end of the story. Unscrupulous people (and companies) still find ways to lure people into Ponzi schemes, usually by promising unusually high rates of return on investments. For example, Woodbridge Group of Companies was recently found guilty of bilking 8,400 investors.⁷

As previously mentioned, businesses in the pharmaceutical industry are often criticized because of the rising prices of drugs. Critics argue that pharmaceutical companies reap huge profits at the expense of the average consumer. In its defense, the pharmaceutical industry argues that prices must be set high to cover the costs of research and development programs to develop new drugs. Similarly, oil companies are sometimes criticized for reaping big prices when gas supplies are low and prices are high. The solution to such problems seems obvious: Find the right balance between reasonable pricing and price gouging (responding to increased demand with overly steep price increases). But as with so many questions involving ethics, there arise significant differences of opinion about the proper balance.

Another problem is global variations in business practices. In many countries, bribes (sometimes called "expediting payments") are a normal part of doing business. U.S. law, however, forbids bribes, even if rivals from other countries are paying them. A U.S. power-generating company once lost a \$320 million contract in the Middle East because it refused to pay bribes (although not called that, of course) that a Japanese firm used to get the job. Walmart's Mexico subsidiary has been charged with paying \$24 million in bribes to local officials to sidestep regulations and obtain construction permits for new stores.⁸ We'll discuss some of the ways in which social, cultural, and legal differences among nations affect international business in Chapter 4.

Assessing Ethical Behavior

What distinguishes ethical from unethical behavior is often subjective and subject to differences of opinion. So how can we decide whether a particular action or decision is ethical? The following three steps set a simplified course for applying ethical judgments to situations that may arise during the course of business activities:

- 1 Gather the relevant factual information.
- 2 Analyze the facts to determine the most appropriate moral values.
- 3 Make an ethical judgment based on the rightness or wrongness of the proposed activity or policy.

Unfortunately, the process doesn't always work as smoothly as these three steps suggest. What if the facts aren't clear cut? What if no moral values are agreed on? Nevertheless, you must make the judgment and decide how to go forward. Experts point out that judgments and decisions made in a moral and ethical manner lead to increased trust among all parties concerned. And trust is indispensable in any business transaction.

To fully assess the ethics of specific behavior, we need a more complex perspective. Consider a common dilemma faced by managers with expense accounts. Companies routinely provide managers with accounts to cover work-related expenses, hotel bills, meals, and rental cars or taxis when they're traveling on company business or entertaining clients for business purposes. They expect employees to claim only work-related expenses.

If a manager takes a client to dinner and spends \$100, submitting a \$100 reimbursement receipt for that dinner is accurate and appropriate. But suppose that this manager has a \$100 dinner the next night with a good friend for purely social purposes. Submitting that receipt for reimbursement would be unethical, but some managers rationalize that it's okay to submit a receipt for dinner with a friend when they are on a business trip. Perhaps they tell themselves that they're underpaid and just "recovering" income due to them. (Most companies would allow reimbursement for the manager's meal, just not for the friend's meal.)

Ethical *norms* also come into play in a case like this. Consider four such norms and the issues they entail:⁹

- 1 **Utility.** Does a particular act optimize the benefits to those who are affected by it? (That is, do all relevant parties receive "fair" benefits?)
- 2 **Rights.** Does it respect the rights of all individuals involved?



eldar nurkovic/Shutterstock

This manager is traveling on business. While in Chicago she invites an old college friend to join her for dinner. Assuming the dinner and conversation are social and not work-related, it would be unethical and illegal for her to charge her friend's meal to her expense account. Of course, it would be fine for her to charge her own meal to her company.

3 **Justice.** Is it consistent with what’s fair?

4 **Caring.** Is it consistent with people’s responsibilities to each other?

Figure 2.1 incorporates the consideration of these ethical norms into a model of ethical judgment making.

Now let’s return to our case of the inflated expense account. Although the utility norm acknowledges that the manager benefits from a padded account, others, such as coworkers and owners, don’t. Most experts would also agree that the act doesn’t respect the rights of others (such as investors, who have to indirectly foot the bill). Moreover, it’s clearly unfair and compromises the manager’s responsibilities to other stakeholders by violating their trust. This particular act, then, appears to be clearly unethical.

Figure 2.1, however, also provides mechanisms for dealing with unique circumstances. Suppose, for example, that our manager loses the receipt for the legitimate

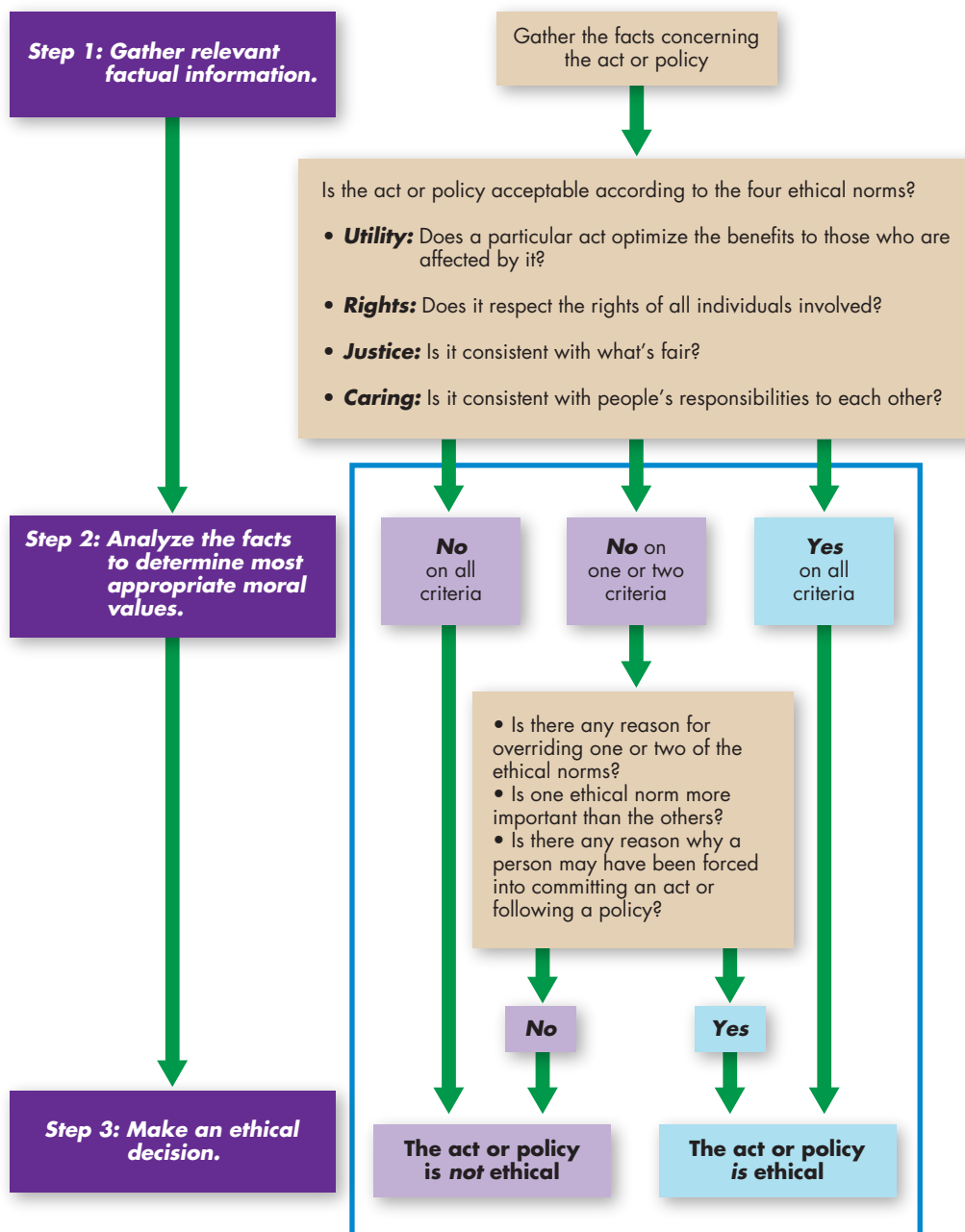


FIGURE 2.1 Model of Ethical Judgment Making

dinner but retains the receipt for the social dinner. Some people will now argue that it's okay to submit the illegitimate receipt because the manager is only doing so to get proper reimbursement. Others, however, will reply that submitting the alternative receipt is wrong under any circumstances. We won't pretend to arbitrate the case, and we will simply make the following point: Changes in most situations can make ethical issues either more or less clear cut.

Company Practices and Business Ethics

As unethical and even illegal activities by both managers and employees plague more companies, many firms have taken additional steps to encourage ethical behavior in the workplace. Many set up codes of conduct and develop clear ethical positions on how the firm and its employees will conduct business. An increasingly controversial area regarding business ethics and company practices involves the privacy of e-mail and other forms of communication that take place inside an organization. For instance, some companies monitor online searches conducted by their employees; the appearance of certain key words may trigger a closer review of how an employee is using the company's computer network. Although some companies argue they do this for business reasons, some employees claim that it violates their privacy.

Perhaps the single most effective step that a company can take is to demonstrate top management support of ethical standards. This policy contributes to a corporate culture that values ethical standards and announces that the firm is as concerned with good citizenship as with profits. For example, when United Technologies (UT), a Connecticut-based industrial conglomerate, published its 21-page code of ethics, it also named a vice president for business practices to ensure that UT conducted business ethically and responsibly. By formulating a detailed code of ethics and employing a senior official to enforce it, the firm sent a signal that it expects ethical conduct from its employees. Two of the most common approaches to formalizing top management commitment to ethical business practices are *adopting written codes* and *instituting ethics programs*.

Adopting Written Codes Like UT, many other businesses (Starbucks, Texas Instruments, Boeing, Apple, and Microsoft among them) have written codes that formally announce their commitment to do business in an ethical manner. The number of such companies has risen dramatically in the past three decades, and today almost all major corporations have written codes of ethics. Even Enron had a code of ethics, but managers must follow the code if it's going to work. On one occasion, Enron's board of directors voted to set aside the code to complete a deal that would violate it; after the deal was completed, the board then voted to reinstate the code! More recently, even though Boeing has a code of ethics, it was apparently violated more than once during the development and launch of the troubled 737 MAX.¹⁰

Figure 2.2 illustrates the role that corporate ethics and values should play in corporate policy. You can use it to see how a good ethics statement might be structured. Basically, the figure suggests that although strategies and practices can change frequently and objectives can change occasionally, an organization's core principles and values should remain steadfast. Hewlett-Packard, for example, has had essentially the same written code of ethics, called *The HP Way*, since 1957. Its basic elements are the following:

- We have trust and respect for individuals.
- We focus on a high level of achievement and contribution.
- We conduct our business with uncompromising integrity.
- We achieve our common objectives through teamwork.
- We encourage flexibility and innovation.

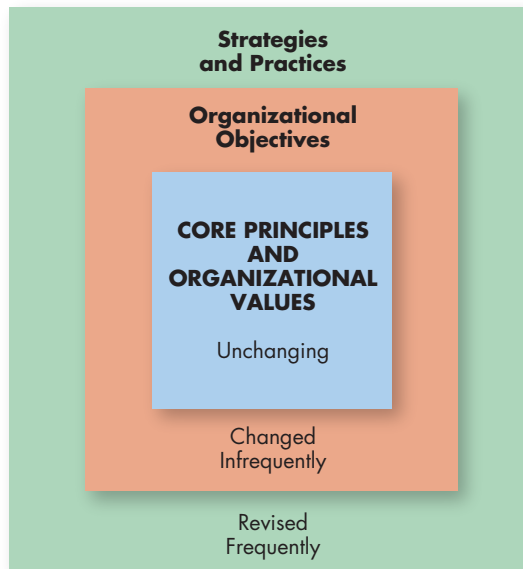


FIGURE 2.2 Core Principles and Organizational Values

Instituting Ethics Programs Many examples suggest that managers can learn ethical responses through experience. Businesses that sincerely stress the importance of ethical behavior and that consistently promote ethical cultures tend to have fewer ethical scandals than businesses that only pay lip service to ethics. But can business ethics be taught, either in the workplace or in schools? Not surprisingly, business schools have become important players in the debate about ethics education. Most analysts agree that even though business schools must address the issue of ethics in the workplace, companies must take the chief responsibility for educating employees. In fact, more and more firms are doing so.

For example, both ExxonMobil and Microsoft have major ethics programs. All managers must go through periodic ethics training to remind them of the importance



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Wells Fargo has had a long-standing reputation for maintaining high ethical standards. However, this reputation was tarnished when a major scandal broke in 2016 and continued into 2018. Bankers at Wells Fargo were being incentivized to open multiple false accounts for the bank's current customers in order to build market share and make it look as though the bank's customer base was growing. In fact, the reported growth was mostly fictitious.