PART 1

THE NATURE OF CONTEMPORARY BUSINESS

Why study business? You see businesses—small, medium, and large—all around you, and they affect your everyday life. Just as you make decisions every day—about how hard you are going to work, how you plan to spend your scarce time and money, and what you intend to do tomorrow to achieve your goals for the future—businesses make similar choices, but on a global scale and with a customer service and profit motive. Events that happen around the world, such as pandemics, wars, scandalous news stories about certain national political leaders and business executives' practices and reassuring stories about corporate leaders who contribute to society, and the pervasiveness of technology (e.g., the Internet) and climate change have direct impacts on business success or failure that touch you every day. All of these are important reasons to study business—to make you more aware of the world around you and how the business environment affects you as a consumer, an employee, or an employer.

In this text you will also learn the fundamentals of all the major functional areas of business—management, marketing, accounting, finance, information systems, and supply chain management. You will come to understand how these functional areas are interrelated and how they are all affected by globalization, technology, and ethics. We hope that this text will help you decide which functional area of business you may want to major in. But if you decide that a business major is not for you, you will still gain valuable commercial insights that will help you succeed in any job you take in the future.

Part 1 sets the stage by examining the nature of contemporary business. It starts with a definition of business and goes on to explore the environmental factors that influence business. It then analyzes and studies the importance of business ethics and corporate social responsibility. Finally, it examines the vigorous world of small business and entrepreneurship.

CHAPTER 1

What Is Business?

Source: PR Image Factor/Shutterstock.com.

Chapter Outline

Learning Objectives

After studying this chapter, you should be able to

1. Identify the three major factors that impact business today and discuss the roles of for-profit and not-for-profit organizations in an economy.
2. Summarize the evolution of business in the United States and explain the key issues that influence its outlook for the future.
3. Explain the fundamental features of the free enterprise, or capitalist, system that make it efficient and dynamic.
4. Discuss the meaning of *market structure* and explain why most industries fall under the banner of monopolistic competition.
5. Discuss the rationale for countries wanting to choose other forms (rather than capitalism) of economic systems and explain what direction most countries are moving toward.
6. Explain how the factors of production affect the supply of goods and services in an economy.
7. Discuss how business performance is measured in a capitalist system versus a socialist system and how the objectives of for-profit businesses differ from the objectives of state-owned enterprises and of not-for-profit organizations.
8. Explain the important role consumers play in determining corporate performance and show how businesses try to identify consumer needs.
9. Discuss why and how national output of goods and services is measured.
10. Evaluate the impact of the digital revolution on businesses, governments, and societies.

How the Chips Fall…

Semiconductor chips, or chips, as they are more popularly known, are micro-circuit boards of transistors that form the brainchild of numerous items from small appliances to sophisticated missiles, satellites, artificial intelligence (AI), and high-speed supercomputers. Over the years, chips have become increasingly complex and miniaturized, thereby packing more punch and costing less in computational and processing speed. Chips come in various types; e.g., relatively low-cost memory chips, micro-processors, to high-end graphics cards. In terms of global market demand, the major consumers of semiconductor chips are manufacturers of personal computers (PCs) that account for some 30 percent of market, followed by smartphones (20 percent), and the automobile and data centers accounting for another 10 percent. All sorts of equipment (big and small) as well as machinery, aircraft, missiles, and satellite systems consume the rest. As you can see, semiconductor chips are indispensable, as they form the nerve center for most non-manual equipment, machinery, and operating systems. Because of increased automation and energy conservation, the demand for efficient semiconductor chips of various kinds is bound to increase over time.

To meet the anticipated demand for semiconductors, chip manufacturers continue to invest heavily in either setting up new manufacturing facilities or expanding existing ones. The three largest firms that invest heavily in the semiconductor manufacturing sector are TSMC (Taiwan Semiconductor Manufacturing Corporation), Samsung Electronics of South Korea, and Intel of the United States. Based on the production volume and sophistication level of semiconductor chips manufactured globally, the top four companies in terms of market capitalization (number of shares/stocks outstanding in the market times dollar price per share) in 2022 were TSMC, Nvidia (United States), Samsung Electronics, and Intel.

Two major business characteristics impact the semiconductor industry: (1) Moore's Law and (2) the Semiconductor Cycle. Moore's Law essentially implies that semiconductor chips, computers/machines that run using these chips, and computing power all become smaller, faster, and cheaper with time, as semiconductor chip technology gets more sophisticated and efficient. The semiconductor cycle, on the other hand, explains the lag in time (normally up to two years) between identifying the demand for chips and factories' ability to come onstream to supply that need.

Compounding these business issues are the challenges of the global geopolitical environment. After winning the U.S. presidency in 2016, the Trump administration implemented trade restrictions on China for perceived unfair trade practices. The administration imposed export controls on China by denying Chinese companies access to specialized semiconductors and equipment to manufacture them as well. China's response was to diversify production by increasing domestic R&D and raising local chip production. The onset of the COVID-19 pandemic and subsequent supply chain disruption of semiconductor chips from Asia, the world's largest exporter, resulted in stalling production of automobiles, numerically controlled machinery, appliances, etc., especially in the United States. Furthermore, sanctions imposed primarily by the North Atlantic Treaty Organization (NATO) and its allies on Russia for its invasion of Ukraine (special-military operations as stated by Russia) further complicated global semiconductor chip production and trade. China aligned itself with Russia, whereas several other countries remained neutral because of the complexity of the situation. Hence, security of the semiconductor chip supply has taken greater prominence in several countries.

To secure reliable access to semiconductor chips, especially the cutting-edge variety within national borders, governments are moving away from efficiencies of free trade and are resorting to subsidizing domestic production and R&D. For example, in July 2022, the United States legislature passed the CHIPS-plus Act, which will provide $52 billion in investment subsidies and R&D support over a five-year period for semiconductor chip manufacturers to develop and increase domestic supply. Similarly, the European Union (EU) plans to provide €43 billion in subsidy through 2030 for EU chip production, and China, India, Japan, and South Korea are embarking on similar schemes—taxpayers beware! Economists are concerned that state largesse could lead to massive chip manufacturing inefficiencies and compound the semiconductor cycle, leading to global excess semiconductor production capacity and wasteful duplication in manufacturing just when chip demand may likely moderate. Ultimately, time will tell how the chips fall!

Source: "When the Chips Are Way Down," *The Economist*, July 16, 2022, pp. 59–61.

Introduction

LEARNING OBJECTIVE 1
Identify the three major factors that impact business today and discuss the roles of for-profit and not-for-profit organizations in an economy.

Business is *global* in nature regardless of where you live. Also, we live in an *information technology* age, where developments—scientific, social, environmental, or commercial—in one part of the world can and will be transmitted across national boundaries instantaneously via the cloud and big data networks. As illustrated in the opening story, entrepreneurs who can identify opportunities in a changing business environment and commercialize them are bound to do well, provided they stick to some fundamental principles of business and *ethics* as discussed in Part 1 of this text. Yet, because of competition, there will always be winners and losers in business.

Defining Business and Profit

When you ask yourself the question, "What is business?" as you commute to class, the first things that you may recall are the stores and billboards that you see on your route. These may include gasoline stations such as Exxon and Shell; fast-food establishments like McDonald's and Burger King; car dealerships like Ford, Hyundai, Tesla, and Toyota; airlines like American, British, and Cathay Pacific; retailing giants like Walmart and Amazon; smartphone manufacturers like Apple and Samsung; even a hairstylist or a Salvation Army store. In technical terms, these operations—big and small—are called **businesses**. There is one thing common to all these operations: They are all trying to create value for their customers.

businesses Those organizations that try to create value for the customer.

Peter Drucker, an Austrian-American and world-renowned management professor and consultant, defined businesses as just that, those organizations that create value for the customer. If businesses did not create value, that is, if they did not meet a customer's unsatisfied need, they would not make any profit and will therefore cease to exist.

Basically, there are two types of businesses. The first type, which comprises most businesses in the world today, exists to make a profit. Simply put, **profit** is the difference between revenue (income or sales) and expenditure (cost of goods or services sold). This means that these businesses produce goods (e.g., gasoline, burgers, cars, cell phones, and computers) or services (e.g., haircutting, laundering, banking, and social media connecting to the world) to meet customer need for a profit.

profit The difference between revenue (income or sales) and expenditure (cost of goods or services sold).

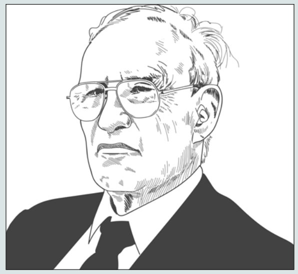
The businesses that make up the second type are called **not-for-profit organizations**. Examples are the Salvation Army, Goodwill Industries, most educational institutions, nongovernment organizations (NGOs), and the like. Their primary objective is to provide vital goods and services to society without the goal of making a profit. Some of these not-for-profit organizations may charge a nominal amount for their goods and services, but this is meant to cover basic business cost, even if some of the items are donated. While not-for-profit organizations play an extremely important role in society worldwide, we will focus more attention on "for-profit" businesses.

not-for-profit organizations Institutions whose primary objective is to provide goods and services to society without the goal of making a profit.

For-profit businesses provide a whole array of goods and services to society. Did you ever wonder why businesses are so eager to sell their goods and services? Surely, it is not to make themselves feel good. It is for profit! The more goods and services that businesses sell, the more profit they hope to make. The more profit they make, the greater is

PROFILES IN BUSINESS

Peter Ferdinand Drucker



Source: TPYXA_ ILLUSTRATION/Shutterstock .com.

Peter Ferdinand Drucker (November 19, 1909–November 11, 2005) was an Austrian-American management consultant, educator, and author, whose writings contributed to the philosophical and practical foundations of the modern business corporation. He was also a leader in the development of management education, he invented the concept known as "management by objectives" and "self-control," and he has been described as "the founder of modern management."

Drucker grew up in what he referred to as a "liberal" Lutheran Protestant household in Austria. His mother, Caroline Bondi, had studied medicine, and his father, Adolf Drucker, was a lawyer and high-level civil servant. Drucker was born near Vienna, Austria, in a small village named Kaasgraben. He grew up in a home where intellectuals, high government officials, and scientists would meet to discuss new ideas. They included Joseph Schumpeter, Friedrich Hayek, and Ludwig von Mises.

Drucker earned a doctorate in international law and public law from the Goethe University, Frankfurt, in 1931. After migrating to the United States in the early 1940s, Drucker became a naturalized U.S. citizen in 1943. After 22 years at New York University as a Professor of Management (1950 to 1971), Drucker moved to California, where he developed one of the country's first executive MBA programs at Claremont Graduate School. Drucker believed that management was "a liberal art," and he infused his management advice with interdisciplinary lessons from history, sociology, psychology, philosophy, culture, and religion. He also believed strongly that all institutions, including those in the private sector, have a responsibility to the whole of society. "The fact is," Drucker wrote in his 1973 *Management: Tasks, Responsibilities, Practices*, "that in modern society there is no other leadership group but managers. If the managers of our major institutions, and especially of business, do not take responsibility for the common good, no one else can or will." Drucker's writings would be marked by a focus on relationships among human beings, as opposed to the crunching of numbers. His books were filled with lessons on how organizations can bring out the best in people and how workers can find a sense of community and dignity in a modern society organized around large institutions.

Drucker's 39 books have been translated into more than 36 languages. He also penned a regular column in the *Wall Street Journal* for 10 years and contributed frequently to the *Harvard Business Review*, *Atlantic Monthly*, and *The Economist*. Drucker's books and articles, both scholarly and popular, explored how humans are organized across the business, government, and nonprofit sectors of society. He is one of the best-known and most widely influential thinkers and writers about management theory and practice. His writings have predicted many of the major developments of the late twentieth century, including privatization and decentralization; the rise of Japan to economic world power; the decisive importance of the consumer and marketing; and the emergence of the information society with its necessity of lifelong learning. In 1959, Drucker coined the term "knowledge worker," and later in his life considered knowledge-worker productivity to be the next frontier of management.

From 1971 until his death, he was the Clarke Professor of Social Science and Management at Claremont, named the Peter F. Drucker Graduate School of Management in his honor in 1987. Drucker died on November 11, 2005, in Claremont, California, of natural causes at age 95. He had four children. Drucker's wife, Doris, died in October 2014 at the age of 103. Drucker was awarded the Presidential Medal of Freedom by U.S. President George W. Bush on July 9, 2002. He also received several honors from the government of Austria, including the Austrian Cross of Honor for Science and Art, 1st class in 1999.

Source: Rawpixel.com/Shutterstock.com.

NGO discussing strategies for getting vaccines out to developing countries.

the income to the owners of these businesses. Is this fair? Sure! These businesspeople have invested their money and time and have taken a **risk** to create goods and services that they hope consumers will buy. Risk is nothing but the probability that the business will fail. When a person takes a risk by investing his or her money and time setting up a business, he or she expects to be rewarded for it. The reward, which is profit, is never guaranteed. Why? Well, it depends on the consumer. If the consumer does not see the need for the product (or service) or does not like the product or service for whatever reason, then the consumer will not buy it. Consumers all over the world behave in a similar fashion, although for cultural reasons they may have dissimilar tastes. If consumers do not purchase goods and services provided by businesses, profits will not be realized, and businesses will cease to grow or they may even fail. Only when businesspeople see the potential to make profits will they be willing to invest their savings in these firms so that the company may grow and generate even greater profits for investors. This growth helps the whole country, since when business grows, more people (including high school and college graduates) will be hired to take on the new jobs being generated. As employment increases, tax (federal and state income taxes, state sales tax, and property taxes) collection increases, and that will lead to more or better public services (schools, roads, natural environment, and police). In addition, as employment increases, people will want to buy houses, smartphones, Internet services, cars, and other necessities and luxuries of life. This in turn will boost the economy even further. That's one of the main reasons why a country's economic and financial managers and professional investors pay such close attention to corporate profits. The level and rate of growth of corporate profits are bellwethers that indicate the health of business and the economy as a whole.

risk The probability that the business will fail.

✔ Reality Check
What are the major not-for-profit organizations in your community? Do you think they play an important role in the community?

The Evolution of Business in the United States

LEARNING OBJECTIVE 2
Summarize the evolution of business in the United States and explain the key issues that influence its outlook for the future.

The origin of business in the United States is fascinating and can be traced to the time when settlers from Europe crossed the Atlantic Ocean. The business climate reflected a combination of different government institutions and policies, the availability of abundant land and diverse natural resources, and a constant and growing inflow of migrants and capital, initially from Europe. All these factors helped fuel the growth of American cities and founded and developed important industries. (The evolution of U.S. business is summarized in Exhibit 1.1.)

1825 1850	1875 1900	1925	1950	2018 Present
The Industrial Revolution • Birth of the factory system • Introduction of labor-saving equipment	**The Railroad Era** • Coast-to-coast business expansion • Growth of monopolies and introduction of antitrust laws	**The Assembly Line Era** • Introduction of scientific management in manufacturing • Birth of labor laws and labor unions	**The Globalization Era** • Liberalization of international trade and investment regulations • Innovations in IT and the Internet • Tightening of corporate governance regulations and ethics	**The Reimagining Globalization Era** • Implementing America first trade/investment/security policies reinforced by the business impact of the COVID-19 pandemic and sanctions imposed on Russia (followed by its retaliation) for its invasion/special military operations in Ukraine • Geopolitically accelerating the growth of a divergent multipolar world based on regional blocs of countries with similar economic/political ideology competing globally while practicing diversity, equity, and inclusiveness on a global scale • Introducing protectionism and supply chain inefficiencies in the name of national security and raising the level of socialism to contain the rise of China • Promoting ESG (environmental, social, and governance) investing despite dubious measurement benchmarks rather than focusing on emission control (carbon footprint) • At the corporate level, witness worsening employee work ethic since complacency and a sense of entitlement set in
1815	*1875*	*1913*	*1944*	*2018*

EXHIBIT 1.1 The Evolution of Business in the United States

The Industrial Revolution and the Growth of the Factory System in the United States

During the 60 years between 1815 and 1875, the Industrial Revolution, which began in Great Britain, transformed the United States from an agrarian economy into an industrial giant. Britain's Industrial Revolution had its spillover effects in such areas as railways, roads, harbors, electric power plants, and telephone and telegraph systems.[1] The United States, with its continental-sized land mass, large mineral deposits, relatively scarce but growing labor force (partly reflecting slave trade), and individualist philosophy, offered profit-seeking businesspeople the opportunity to earn a high return on their investment. Agriculture in the United States was very profitable and led to rising farm incomes and a strong demand for standardized consumer products.

factory system A method of mass production in which raw materials, machinery, and labor are brought together in large volumes in one location to produce goods less expensively than in dispersed locations.

The Industrial Revolution brought with it new technologies that facilitated mass production of standardized items beneath one roof—the **factory system**. Under the factory system of mass production, raw materials, machinery, and labor were brought together in large volumes in one location to produce goods less expensively. Since production was on a large scale, raw materials and machinery could be purchased in bulk and at lower cost. However, the growing demand for mass-produced goods led to labor shortages in factories. This caused labor cost to rise, which in turn forced businesses to invent and adopt labor-saving equipment and manufacturing techniques that became a unique feature of "Yankee ingenuity." The new machines could produce goods faster, cheaper, and more uniformly (and of better quality) than those produced by hand. Over time, this type of manufacturing process led to the **specialization of labor**; that is, employees were grouped together based on their skills and factory demand and were increasingly assigned to specific tasks.

specialization of labor Grouping employees to work on assigned tasks based on their specific skills and factory demand.

The Railroad Era

In the early 1870s, the railroad drove economic expansion, encouraged massive speculation, and created fabulous wealth. Continental railroads turned the United States into a unified market from coast to coast. Retailers expanded to serve immigrants (including indentured Chinese labor) who were instrumental in building the railroad system. Land values soared along the rail routes, and cargo that took weeks to travel by boat and wagon could now be moved in days. The railroad era, like the dotcom era of the late 1990s and early 2000, was riddled with speculation, corruption, and miscalculation. Rail barons worked political connections to obtain federal land grants, and speculators grew rich. During this period, the advanced technologies developed by U.S. business made the United States the most important country among the industrialized nations of the world. For example, during the 1875 to 1913 period, the U.S. share of world manufacturers rose from 23 to almost 36 percent while Britain's declined from nearly 32 to only 14 percent.

laissez-faire The economic doctrine that advocates total government inaction in business, so businesses are free to do what and as they please.

This largely reflected the rapid growth of the relatively young country and the **laissez-faire** system followed by the nation at that time. The principle of laissez-faire advocates total government inaction in business; that is, businesses are free to do what and as they please. Key contributing factors to U.S. economic growth were a steady natural increase in domestic population supplemented by a large immigration (including imported slaves) inflow and a high rate of business investment. Businesses exploited the buoyant economic conditions, which supported a rising standard of living for most Americans. This period also saw one of the most rapid growths in the number and size of companies in the United States. A side effect of the laissez-faire system was that it encouraged companies to consolidate (merge) and dominate the market. **Market domination** was established through either acquiring competitors or colluding with companies that resisted acquisition. As their size grew, some of these firms became so powerful that they dominated the market by controlling product prices and preventing competitors from entering the market. Consumers as well as affected businesses protested this unregulated laissez-faire system. This ultimately led the U.S. government to institute **antitrust policies**—laws designed to break up monopolies and control monopoly abuses—in 1890 and 1914. Antitrust laws set limits on firm behavior by prohibiting certain kinds of anticompetitive practices (like price fixing, market sharing, predatory pricing, and exclusionary activities).

market domination A strategy of either acquiring competitors or colluding with them to control product prices and prevent new competitors from entering the market.

antitrust policies Government laws designed to break up monopolies and control monopoly abuses by business.

The Assembly-Line Era

A new era in manufacturing began in 1913 when the Ford Motor Company started mass production of Model T cars at its Highland Park, Michigan, plant in the United States. Ford used an assembly line where the factory worker remained in one spot and the car came to the worker to be assembled. This system of production was based on studies to determine the most efficient approach to production. The idea was to avoid unnecessary movement on the part of the worker to complete a specific job. In a system that brings an incomplete car on an assembly-line track to a worker, the time and effort needed to perform a specific task is minimized as compared with a system in which the car's position is fixed and workers must spend a lot of time moving around it. The net result was that the assembly line reduced production cost and made cars more affordable, thereby encouraging sales. The assembly line is still used in several industries today, although the techniques for using it have been further refined. The drawback of this system is the monotony that it creates for the worker and the ever-increasing pressure to perform better and faster. Assembly-line employees complained about the rigors of working under those conditions. This contributed to the formation of labor unions that strove to protect workers' rights. The government's role increasingly became one of a mediator between labor (preventing exploitation of workers) and business (preventing unreasonable demands on firms that could lead to their financial ruin).

The Post–World War II Period: The Globalization Era

Europe was physically devastated after World War II, while the U.S. infrastructure was relatively unharmed. To rebuild Europe, the United States instituted and paid for the Marshall Plan. In addition, several important international institutions were set up under U.S. leadership to develop new rules for facilitating international trade, foreign investment, and global economic growth. Key among these international financial institutions were the International Monetary Fund (IMF) and the World Bank, both headquartered in Washington, D.C. The IMF's role was essentially to facilitate and support stable exchange rates (of currencies) and the flow of capital (money) between countries so that countries could increasingly invest and trade with each other without being too concerned about the value of their currencies. The World Bank was set up as an international development institution whose primary role was to provide financial and technical assistance to rebuild Europe. Only countries that were members of the United Nations could choose to become members of the IMF and the World Bank. Member countries provided aid money to the World Bank for investment in needy members on relatively easy repayment terms, while some funds were disbursed as interest-free grants. Although World Bank funds were initially geared to rebuilding Europe, rapid recovery in Europe soon led to the diversion of development funds to other lower-income countries of the world.

To facilitate trade, the General Agreement on Tariffs and Trade (GATT), a United Nations institution, was established in 1947. The GATT sets rules of conduct for international trade policy and is headquartered in Geneva, Switzerland. Much of the multilateral tariff reduction that has taken place since World War II has been accomplished under the GATT (renamed the World Trade Organization [WTO] and commenced operations on January 1, 1995). Over the years several rounds of trade policy liberalization have taken place. Each trade liberalization step has led to the accelerating **globalization** of business because tariffs were lowered further, and quotas eliminated. This, in turn, gave a boost to international competition through the increased exports of goods and services, as well as capital flows between countries. Globalization is the process of integrating the market for goods and services worldwide. One could argue that the globalization of business, which began after World War II, has led to the worldwide economic and social advances that we are witnessing even today.

globalization The process of integrating the market for goods and services worldwide by reducing or eliminating trade and investment barriers across countries.

The Reimagining Globalization Era

The era of reimagining capitalism and globalization in the United States began with the populist election of Donald Trump as the president of the country in 2016 on a platform of closed borders and China containment because of their alleged mercantilist trade practices. The retreat from globalization began with U.S. imposition of massive tariffs on major imports from China and restrictions on technology exports (to China as well as on some allies). This trade distortion was compounded by pandemic-induced supply chain disruptions and the North Atlantic Treaty Organization's (NATO spearheaded by the United States) economic sanctions imposed on Russia for its invasion of Ukraine (a NATO-aspiring member bordering Russia) that was exasperated by the predictable counter sanctions imposed by Russia on "unfriendly" countries. The global business and economic impacts of these developments have been dire, especially for many sidelined developing countries that were impacted by inflation caused by the subsequent food and energy shortages. The overall impact on the United States and other developed countries is a realignment from efficient just-in-time and just-in-sequence production processes to a more inefficient supply chain diversification and resilience that are based on protection, government subsidies, duplicate, and/or domestic sourcing of goods and services. While security of supply is a worthy goal, incipient self-sufficiency, economic concentration, and subsidized production lead to high cost to consumers and a weaker economy that may not be able to fund pressing initiatives to overcome externalities like climate change and unforeseen pandemics. Investors' support for corporate Environmental, Social, and Governance (ESG) commitment calls for greater globalization, not less. This implies that when countries advocate diversity, equity, and inclusiveness at home, they should apply the same principles on a global perspective. As the world moves inevitably to a multipolar global economic order, the need for peaceful coexistence with autocracies and other political systems will become imperative.

The New Society of Knowledge Workers[2]

The society that we currently live in is already diverging from that of the twentieth century, which saw the rapid decline of the agricultural sector that had dominated society for thousands of years. In 1913 farm products accounted for 70 percent of world trade, whereas now their share is at most 17 percent. In the early years of the twentieth century, agriculture in most developed countries was the largest single contributor to a country's production of goods and services; now in rich countries its contribution has dwindled to the point of becoming marginal. And the farm population is down to a tiny but vocal proportion of the total.

Manufacturing has traveled a long way down the same road as well. Since World War II, manufacturing output in the developed world has tripled in volume, but inflation-adjusted manufacturing prices have fallen steadily. Manufacturing employment in the United States has fallen from 35 percent of the workforce in the 1950s to less than half that now, without causing much social disruption. However, such a transition in countries such as Japan or Germany, where manufacturing workers still make up 25 to 30 percent of the labor force, is proving difficult. Furthermore, the cost of services, especially prime knowledge products—health care and education—has tripled (even adjusted for inflation) since World War II.

new economy An economy largely driven by developments in information technology and the Internet.

knowledge workers Employees whose jobs require formal/advanced schooling with proficiency in the use of IT tools.

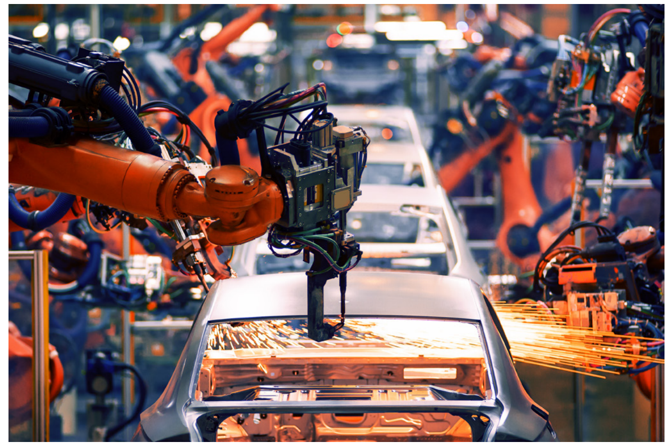
As the **new economy**, largely driven by developments in information technology (big data, cloud computing, blockchain, and artificial intelligence) and the Internet materializes, one thing sure to happen is that the next successful society will comprise **knowledge workers**—people whose jobs require good formal and advanced schooling. In the developed as well as the developing countries of the world, the role that knowledge workers play, especially by using information technology (IT) tools, will be more important than information technology or the Internet itself.

Knowledge will be a key resource, and knowledge workers will be the dominant group in the future workforce. The main characteristics of the knowledge workforce will be

- Borderless, because knowledge travels even more effortlessly than money
- Upwardly mobile, since knowledge will enable everyone who has acquired a good formal education to move up
- Financially successful

Together, these three characteristics will make the global society highly skilled and competitive for businesses and individuals alike. This effect is already illustrated clearly by the volume of knowledge-based manufacturing and services that are being outsourced to countries like China and India.

Information technology, although only one (the others include biotechnology, space science, streaming services, and nanotechnology) of many features of the new society, is already having a tremendous effect: It is allowing knowledge to spread almost instantly and making it accessible to everyone. Given the ease and speed at which information travels, every institution in the knowledge society—not only businesses but also schools, universities, hospitals, and, increasingly, government agencies too—will need to become globally competitive, even though most organizations will continue to be local in their activities and in their markets. The reason is that the Internet and social media will keep customers everywhere informed about what is available and at what price anywhere in the world. This new economy will rely heavily on knowledge workers, which at present describes people with considerable theoretical knowledge and learning: doctors, engineers, scientists, and teachers. The most striking growth, however, is anticipated in knowledge technologists: computer technicians, software designers, clinical lab analysts, manufacturing technologists, and paralegals. Just as skilled manufacturing workers were the dominant social and political force in the twentieth century, knowledge technologists are likely to become the dominant social, and perhaps also political, force over the next decades.


Source: Jenson/Shutterstock.com.

A highly automated car assembly line operated by robots that do the heavy lifting and precision work designed by knowledge-intensive workers who are in the background operating artificial intelligence (AI) computer systems.

✔ Reality Check

Have you seen any changes in business activity in your hometown over the past five years? If yes, what is the cause of these changes?

Types of Economic Systems and Their Impact on Business

Economic resources (land, labor, capital, and technology) are scarce, and no matter how much we have of them, we continue to face a shortage—the inability to have as much as we want at a price that we are willing to pay. Countries have adopted different approaches to allocate these scarce resources among competing demands to generate economic growth and employment. The economic system adopted by any country depends basically on the following factors that have a profound effect on the efficiency of resource allocation, business development, economic evolution, and growth. The country with the most open (ease of entry into and exit out of industry) type of economic system will tend to have the most efficient system of resource allocation and rapid business growth.

economic resources Land, labor, capital, and technology that are scarce.

- Ownership of the factors of production (private versus government)
- Method of resource allocation (market versus government)
- Transparency of economic policies
- Availability of functioning institutions

LEARNING OBJECTIVE 3
Explain the fundamental features of the free enterprise, or capitalist, system that make it efficient and dynamic.

The Free Enterprise, or Capitalist, System

The economic system practiced in the United States is largely **capitalism** (also called the free enterprise or free-market system where product/service price and quantity are determined by their market demand and supply), which is based on private property rights, a free-market system, the pursuit of self-interest (profit or wealth maximization), the freedom to choose, and the ability to borrow money. Far from the popular image of a haven for "corporate fat cats," a capitalist economy crowns the consumer as king, and the system provides for the public's well-being.[3]

capitalism The economic system that is based on private property rights, the free-market system, the pursuit of self-interest, the freedom to choose, and the ability to borrow money.

In the free enterprise system, the key players are consumers and producers. Consumers like you and me are in the market to buy all sorts of goods (books, clothes, toiletries, food, smartphones, etc.) and services (the Internet, airline tickets, concert tickets, season passes for ball games, etc.). Some of these goods and services that we purchase may be imported (e.g., Heineken beer from Holland or a Singapore Airlines ticket). In the **free-market system**, consumers demand certain products or services and are willing to pay a certain price for them based on their usefulness and the consumers' budget. The producer, on the other hand, is willing to supply the goods or services to the consumer at some price, which will depend on the cost of the inputs used in producing the goods or services and a profit margin. In nominal terms, the United States is currently the world's largest economy, followed closely by China, that increasingly practices a free-market system. Most European countries, as well as other developed countries like Japan, South Korea, Taiwan, Singapore, Hong Kong (a Special Administrative Region of China), Chile, and so on, essentially follow the free enterprise system. The relationship between the economic system and business is very close, and unless you understand how a particular economic system works, you may not be able to conduct business in that country successfully. This section explains the fundamentals of the free-market system, which show how private investors identify opportunities for profits based on simple demand and supply analysis of goods and services and the degree of competition in a market.

free-market system The economic system in which consumers demand certain goods and services and are willing to pay a price based on their budget, and producers are willing to supply the goods and services on the basis of a price that will cover their costs and provide a profit margin.

Demand, Supply, and Price

Consumers create a *demand* for goods and services, and the quantity demanded depends on the price of the product or service, as well as on how much money the consumer has at her or his disposal. Literally, there are hundreds of goods and services that people consume to maintain their lifestyle. When they consume any one of these goods and services, they create a separate demand for each product and service. Generally, you will have noticed that when the price of a particular product or service falls, you tend to purchase more of it. This is the idea behind the "special sale" advertisements promoted in newspapers, on TV, and on the radio. Businesses know that when they lower prices, consumers will tend to demand (purchase) more of their product. This behavior has led to what is called the **theory** or **law of demand**: Consumers will buy more when prices fall and less when prices rise. Just imagine what you would do if the price of gasoline were doubled. You would at once try to carpool with your friends to school or work and cut down on your cruising habits too! What you are essentially doing is reducing your demand for gasoline. Just remember, you are not the only one who will cut down on gasoline consumption when prices rise. Your friends and neighbors will do the same as well. In fact, the whole society will do the same thing, and the net impact will be a drop in the demand for gasoline in the whole country. The opposite happens when the price of gasoline goes down. Lower gasoline prices encourage consumption and increase gasoline demand. We can represent this behavior with the help of a diagram.

theory or law of demand The statement, which appears to hold, that consumers will buy more when prices fall and less when prices increase.

Exhibit 1.2(a) shows that when the price of gasoline drops, say, from \$2.00 to \$1.50 per gallon, the quantity of gasoline demanded by a particular consumer increases from 5 to 8 gallons per week. Or, if the price of gasoline increases from \$1.50 to \$2.00 per gallon, the amount of gasoline that a consumer would purchase decreases from 8 to 5 gallons per week. The line *AB* is called the **demand curve**, which shows the relationship between the quantity of gasoline demanded and the price of gasoline for a particular customer. If there were, say, 10,000 students on campus, we could derive the demand curve for each student in a similar fashion. We could then aggregate (total) all the individual demand curves and determine the total number of gallons of gasoline that the 10,000 students would demand at different prices. In a similar manner, we could determine the demand curve for any product or service for the whole city or country. It's that simple. The slope (steepness) of the demand curve is heavily influenced by the consumer's budget for that product or service and by the consumer's taste (spending priority). When the slope of the demand curve is steep, economists characterize the demand represented as **price inelastic demand**. For example, a significant increase in the price of cigarettes will have little effect on the quantity of cigarettes demanded. On the other hand, when the slope of the demand curve is very gentle, then the demand represented is **price elastic demand**. For example, a rel-

demand curve A graph for any product or service that shows the relationship between price and quantity demanded and is downward sloping.

price inelastic demand The demand where significant increases in the price of a product or service will have little effect on the quantity of the product or service demanded.

price elastic demand The demand where a small change in the price will have a significant impact on the quantity demanded of a product or service.

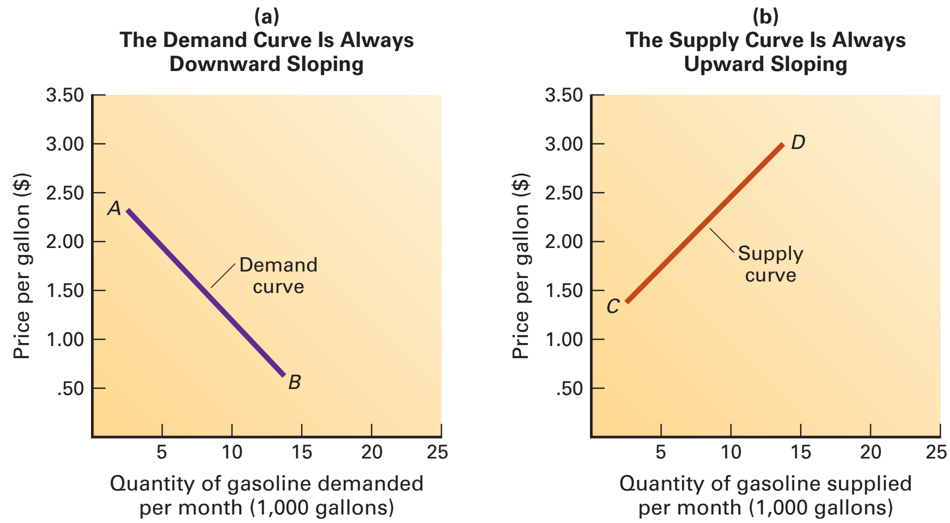


EXHIBIT 1.2 The Demand and Supply Curves

atively small change in the price of DVDs will have a significant impact on the quantity demanded. In the real world, some products, and services, like medical services, are price inelastic. When you get sick and need to see a physician, you are not likely to think twice about the high cost of doctor fees! However, if the price of Levi jeans goes up sharply, you probably will be able to get by without purchasing a new pair of jeans for some time. The demand for jeans is price elastic.

Just as the consumer creates the demand for goods and services, the *supply* of goods and services comes from producers. Producers are willing to supply goods and services at a price that will cover their production costs and generate a reasonable profit. The higher the price, the more goods and services the producer is willing to supply. As prices go up, producers see the opportunity to make greater profits and are therefore willing to supply more goods and services. This behavior on the part of producers is generalized in the **theory** or **law of supply**: Producers will be willing to sell more when prices rise and less when prices fall. In the gasoline case that we just discussed, if the price of gasoline doubled, gas stations would be willing to sell more gasoline so that they could earn greater profits. Low gasoline prices would discourage gas stations from selling gasoline and instead encourage them to sell more items from the convenience stores that are generally attached to the gas stations these days. The producer's behavior can also be explained with the help of the same diagram.

Exhibit 1.2(b) shows what happens when the price of gasoline rises, say, from $1.50 to $2.00 per gallon. The quantity of gasoline that your local gas station will be willing to supply may increase from 5,000 to 7,000 gallons per month. The upward-sloping **supply curve** *CD* clearly shows that as prices rise, the producer is willing to sell more of the product (gasoline in our case). Again, the steepness of the supply curve carries important meaning. If the supply curve is steep, the implication is that large changes in the price will have little impact on the quantity of goods supplied by the producer. For example, electricity has a **price inelastic supply**. On the other hand, when the supply curve slopes gently upward, a relatively small increase in price will bring about significant increases in supply. For example, a product like beef has a **price elastic supply**. One point to remember is that the producer does not just supply one consumer but a whole bunch of consumers in a given market or region. Also, there may be several producers for a single product, in which case an aggregate (total) supply curve can be developed. The aggregate supply curve is also called the market supply curve.

In countries that follow the free-market system, the prices that consumers pay for goods and services are determined by the collective interaction of total consumer demand and cumulative producer supply. The intersection of the market demand and supply curves provides us with the **market clearing**, or **equilibrium**, **price**, the price at which supply

theory or law of supply The statement, which appears to hold, that producers will be willing to sell more when prices rise and less when prices fall.

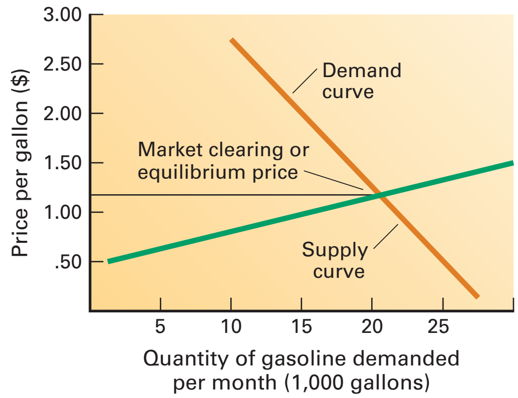
supply curve The curve that shows the relationship between the quantity supplied and the price of a product or service, and it is upward sloping.

price inelastic supply The supply where a large change in the price will have little impact on the quantity of a good or service supplied by the producer.

price elastic supply The supply where a small change in the price will bring about significant increases in the quantity of a product or service supplied by the producer.

market clearing, or equilibrium, price The price at which supply will equal demand.

EXHIBIT 1.3 Market Clearing Price and Quantity



will equal demand and there will be no unsold goods or services. This situation can also be shown with the help of a diagram.

In a free-market system, price will always tend to move toward the equilibrium price so that the market clears—that is, everything that is produced is sold. From Exhibit 1.3 it is clear that if price falls below the equilibrium level, the quantity demanded (represented by the demand curve) will be greater than the quantity supplied by producers (represented by the supply curve). When price is such that demand exceeds supply, then we have a **shortage**. When there is a shortage, price will keep rising, so demand will shrink, and the shortage will become smaller and smaller until it vanishes. You will notice that the shortage vanishes when the price reaches the equilibrium or market clearing price. In the opposite case, when market supply exceeds market demand, we have a **surplus**.

shortage The amount of a good or service that will not be available when the price of the good or service is set below the equilibrium price. (Demand will exceed supply.)

surplus The amount of a good or service that will not be sold when the price of the good or service is set above the equilibrium price. (Supply will exceed demand.)

Private Property and Property Rights

Capitalism is defined as that form of private property economy in which innovations are carried out by entrepreneurs with the help of borrowed money.[4] It is a system based on private property, which does not just imply land but also includes all types of personal property that you see, such as your house, car, furniture, books, stereos, PCs, and so on. In the capitalist system, along with private property comes property rights, that is, your rights to buy, own, use, and sell your property as you see fit. Private property and property rights are things that Americans take for granted. However, in communist countries like China (where property rights are changing very slowly) or in countries that have very recently gained independence from the former Soviet Union (like Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan in Central Asia), private property, especially land title, still belongs to the state (the land may be leased for 70 years or so), and there are severe restrictions on what citizens in these countries can do with their land (the house that they build on the land may belong to them, but not the land!). This lack of property rights severely restricts innovation and business, since people may not have the freedom of choice to do what they want and make a profit. There is little or no incentive to invest in property when people know that the government may take away their land at any time (or when the land lease expires). Private property rights are crucial for success in a free-market system.

✔ Reality Check
How has the price of a typical laptop performed over the past three years? Why?

Degrees of Competition

LEARNING OBJECTIVE 4
Discuss the meaning of *market structure* and explain why most industries fall under the banner of monopolistic competition.

What is competition, and why does it matter? By the time you finish reading this section, you will begin to appreciate the importance of competition, especially as it relates to the price, quantity, and quality of the products and services that are produced and consumed in an economy. Most firms are established to satisfy consumers' unfulfilled needs and, in so doing, to earn profit before the product or service they are selling becomes obsolete. All firms have a life cycle that begins with the introduction of a new, better, or cheaper product. At this stage, firms tend to be most profitable before competitors have had the time to enter the market with a cheaper, better alternative. The potential for profit motivates new entrants into the marketplace, and as the number of firms providing similar goods and services increases, the level of competition intensifies, and prices fall. Unless the original firm increases its efficiency (by cutting production costs and "doing things right") and effectiveness (by introducing new products, markets, and business models, i.e., "doing the right things"), it will become less profitable, then obsolete and fade away. That is the fundamental reason why firms that do not innovate and change with time do not exist forever. Just as perceived profits attract business, in the **product life cycle**, competition forces firms to innovate and become efficient, invest, and outsource products and services abroad or to go out of business. In the capitalist system, the law of the corporate jungle is clear: compete—restructure—or die. This is called the process of "creative destruction." The degree of competition that firms face can vary from industry to industry and from country to country.

product life cycle The theory that explains the different stages—introduction, growth, maturity, and decline—that a product goes through before it fades away.

Market structure is the term that economists generally use to describe the level of competition within an industry. The amount of competition that firms face is determined by the number of firms that operate in that particular industry, the ease of entry into that industry, product homogeneity, and the supplier's control over price. At one end of the industrial spectrum we have agriculture, where there are literally hundreds of thousands of suppliers who produce essentially identical products (e.g., milk, beef, chicken) that are sold at a price determined by market demand and supply. Such a system is called **pure competition**, and it must meet the following market conditions:

market structure The organization of an industry determined by the level of competition within the industry.

pure competition The industry market structure in which a large number of suppliers produce essentially identical products, which are sold at a price determined by the market.

1. The number of firms in the industry must be large, and none must be so big as to have undue influence on the price of the product or service that is being sold.
2. Entry into and exit out of this industry must be relatively easy so that firms can get in and out of this business if they so desire.
3. Each firm must produce a product or service identical to that of the other firms so that consumers cannot differentiate between the products.
4. The price for the product must be determined by the overall market demand and supply, and neither a single supplier nor a single customer must be able to influence prices.

At the other market structure extreme, one could witness a utility (electricity) company that services a large region of a country all by itself. In this case we would have a **monopoly**, that is, a single firm supplying electricity to a large area of customers. This company then behaves like a monopolist (derived from the Greek words *mono* for "one" and *polist* for "seller"). Since this electric utility is the only game in town with no close substitutes for its service, it will be inclined to set prices as high as the market will bear. That is why we have utilities regulated by the government: to make sure that these firms do not make excessive profits, often called monopoly profits. On the basis of the four criteria indicated above, you will notice that entry into and exit out of the utility industry is neither easy nor inexpensive.

monopoly The industry market structure in which there is essentially a single supplier of goods or services that has the power to set prices.

Not all industries are identical in their configuration. In fact, the real world contains a significant mixture of monopoly imperfections along with elements of competition. We can then classify the real world for the most part as having the market structure of **imperfect competition**, one that is neither perfectly competitive nor perfectly monopolistic. Imperfect competition arises when the total industry's output of goods or services is supplied by a small number of firms at market-determined prices. This leads to a consideration of **firm concentration ratios**, i.e., the percentage of the total industry output that is accounted for by the largest firms. Normally, four-firm concentration ratios, defined as the percentage of total industry output that is accounted for by the four largest firms in the industry, are used to measure the monopolistic nature of an industry in a country. In 2021, about 53 percent of total meat (beef, chicken and pork) processing in the United States was accounted for by the four largest companies (JBS, Tyson, Cargill, and Smithfield).[5]

imperfect competition The industry market structure where the industry's output of goods or services is supplied by a relatively small number of firms and price is largely determined by market forces.

firm concentration ratios The percentage of total industry output that can be accounted for by the four largest firms and so a measure of the sellers' market power.

The differences in market structure arise from variations in cost composition between industries as well as from barriers to competition. In some industries, production will need to be on a large scale in order to make economic sense. Take, for example, the automobile industry. Given the huge investment in plant and equipment that will be needed, the thousands of parts required to assemble a car, the spare parts inventory, and the personnel that will be required to manage and operate the plant, average production cost will continue to decline as the number of cars produced increases. Hence, there are significant economies of scale in automobile production that could essentially wipe out small-volume car producers that will invariably have higher average costs. Unless the market for cars is large, it will not make sense, nor will it be profitable to build mini auto plants. That's a major reason why you don't see automobile plants in countries with a small car market. It would make more sense to import cars than to build them in these countries.

barriers to competition Barriers that arise when certain legal restrictions (patent protection, licensing, and tariffs) that reduce the level of competition are imposed on an industry.

patents Awards to companies or individuals by governments to protect their inventions (intellectual property) by providing exclusive rights to the owner to produce the goods (e.g., pharmaceutical products) or services (e.g., software or operating systems) for a set period, thereby preventing others from doing so during that time period.

licensing The practice by governments of selecting investors to operate certain types of businesses, thereby restricting entry into those businesses and reducing competition.

tariffs Taxes on imports that raise the price of imports and consequently enable domestic competitors to raise prices as well.

oligopoly The industry market structure where a few producers of almost identical products cater to the needs of the whole market.

product differentiation A strategy that firms employ to make their product seem different from those of their competitors.

Barriers to competition, also sometimes called barriers to entry, arise when certain legal restrictions are imposed on an industry or when suppliers themselves try to differentiate their products or services. Examples of legal restrictions to competition include patent protection, licensing, and tariffs. **Patents** are awarded to companies or individuals by governments to protect their inventions (intellectual property). Patents provide exclusive rights to the owner to produce goods (e.g., pharmaceuticals) or services (e.g., software) for a set period of time, thereby preventing others from doing so during that period. A patent awards exclusivity, or monopoly rights, to the owner for a given period so that the inventor can recoup the research and development cost of the invention and also earn a certain profit for the effort. **Licensing** operates in a similar manner and is more prevalent in developing countries where governments select certain investors to operate a particular type of businesses (cement manufacturing, steel production, etc.). Licensing restricts entry into an industry, thereby reducing competition. Finally, **tariffs**, which are taxes on imports, raise the price of imports and boost prices to domestic consumers. Domestic producers of import-competing products are therefore provided relief from overseas competition (from lower-cost imports).

Oligopoly How imperfect can imperfect competition get? At one extreme is the monopolist, or single seller. **Oligopoly** implies "few sellers," that is, an industry in which a few sellers cater to the needs of the whole market. An oligopolist is one of these few sellers who produces and sells identical (or almost identical) products like cement, steel, copper, and so on, or services like airlines. Based on the four conditions of market structure that were discussed earlier, you will find that oligopolists are generally large producers, so only a few of them are needed to supply the whole market. Since the products or services sold by oligopolists are quite similar, when an oligopolist lowers prices, consumers will at once switch to the lower-price seller. In order not to lose market share, the other oligopolists will be forced to match the lower prices or go out of business. If you use commercial airlines, you will understand what we mean. For example, if American Airlines lowers its fare between any two cities, other carriers that cater to that pair of cities will lower their prices as well and will match American's fare; otherwise, customers will flock to American Airlines. Unlike a monopolist, the oligopolist does not control prices, but each can have a great effect on market price, especially downward.

Monopolistic Competition The key characteristic of monopolistic competition is **product differentiation**. Although there are quite a few sellers in this type of market structure, each firm will try to make its product sound or appear different from the rest. Although the number of producers remains large (not as large as in pure competition), each firm will try to advertise and promote its products as if they are unique. Take, for example, jeans, which are a common product. However, through the creation of brand awareness, brands like Polo, Calvin Klein, Levi's, Wrangler, Lee's, Rustler, and so on, the companies try to give the consumer the impression that their jeans are something out of the ordinary—in a class by themselves. Each company tries to convey to the consumer that its jeans are unique—one of a kind—in the market, and it wants to behave like a monopolist in the market for its jeans. This way it can try to charge a monopoly price. While some consumers may say that jeans are jeans and go for the ones that cost the least, there are others who are convinced that "there is nothing between me and my Calvins" and are willing to pay a high price for a pair of Calvin Klein jeans.

Since product differentiation is such an important part of monopolistic competition, firms in this industry spend a tremendous amount of money on advertising to convince the consumer that their product is truly different. Other industry examples of differen-

EXHIBIT 1.4 Market Structure

Most industries fall in the category of monopolistic competition.

	Pure Competition	Monopolistic Competition	Oligopoly	Monopoly
Where prevalent	Agricultural products, e.g., corn, rice, wheat	Retail trade, e.g., fast food, gasoline	Airlines, autos, construction materials, e.g., cement, steel	Utilities, e.g., cable TV, telephone, electricity
Number of producers	Numerous	Many but not as numerous	Few	Single producer
Product differentiation	Identical products	Perceived differences in product	Some difference in product	Unique product with no close substitutes
Barriers to entry	None	Relatively easy	Relatively difficult	Regulated by government
Degree of control over price	None	Some	Some	Considerable
Methods of market promotion	Minimal promotion	Heavy advertising to differentiate product	Advertise heavily to promote perceived quality	Advertise service, quality, and reliability

tiated products include perfumes, soda pop, toothpaste, detergents, makeup, sneakers, gasoline, and so on. While the utility value of all the products within a category may be about the same, the aura of the specific product enables the supplier to charge a higher price and reap some monopoly profit.

Exhibit 1.4 summarizes the basics of market structure in a capitalist system. The degree of competition varies from pure competition with numerous sellers of identical products, to a large number of sellers of differentiated products, to a system of few sellers of almost identical products, to the limiting case of a single seller—a monopolist. Each structure is associated with a particular pricing mechanism, which is important to businesses and consumers.

✔ Reality Check

How has the price of a typical laptop performed over the past three years? Why?

The Command, or Planned, Economic System

LEARNING OBJECTIVE 5

Discuss the rationale for countries wanting to choose other forms (rather than capitalism) of economic systems and explain what direction most countries are moving toward.

Capitalism is a system based on profits and efficient resource allocation, along with the primary goal of satisfying consumer demand. At the other end of the spectrum of global economic systems is the **command**, or **planned**, **economic system**, in which ownership and control of all the factors of production are totally in the hands of the government and not the private citizens. The concept of private property does not exist in this system, and the government makes all decisions on which goods and services will be produced, where they will be produced, how much of those goods and services will be produced, and at what price they will be sold. As you can see, the consumer has little say in such a system. In the command economic system, the government plans (hence it is sometimes called the planned economic system) production based on national goals and an elaborate analysis of sources and uses of resources available in the economy. The government's objectives are to

command, or planned, economic system The economic system in which the ownership and control of the factors of production are totally in government hands.

- Utilize as much of domestic resources as possible, since these countries invariably focus on domestic self-sufficiency and not on international trade
- Employ whoever is willing to work to solve unemployment and poverty
- Minimize income inequality among workers by diminishing wage differentials
- Provide limited choice to workers in terms of where to work and what type of work they can undertake

The command economic system is based on the assumptions that the government knows what is best for the consumer and the country and that it should try to eliminate wasteful conspicuous consumption. The consumer certainly is not the king in the command economic system. While the command economic system seeks to minimize the exploitation of workers, it does so at a great expense to efficiency and consumer choice (e.g., in the former Soviet bloc countries and in present-day Cuba and North Korea). In the long run, countries that follow the command economic system invariably end up bankrupt. The market mechanism is not allowed to operate, and there are no incentives for earning profits. In general, a curious thing to notice in command economies is the almost total lack of quality consumer goods. When goods are available, there is not much of a choice, and the goods are of relatively poor quality. If a product happens to be appealing to consumers, it will invariably be in short supply, since prices are not based on supply and demand—the government sets them! Furthermore, the concepts of competition and private property do not exist. All these elements contribute to the production of a whole bunch of goods that consumers do not want and also lead to an acute scarcity of other goods that consumers really do want.

state enterprises Government-owned firms that produce goods and services, generally in command and mixed economic systems.

Firms that produce goods and services in a command economic system are run by the government and are called **state enterprises**. State enterprises are essentially inefficient bureaucracies that employ far more workers than needed for efficient production. Prior to 1978, when China was a command economy, most Chinese consumers wore gray drab outfits and had little to look forward to in terms of consumer goods and choices. With the introduction of a free enterprise system in China in 1978 and the nascent economic reform and privatization of state enterprises, China is becoming a relatively capitalist country with communist roots.

The Mixed Economic System

Very few economies in the world practice pure capitalism. Hong Kong, a Special Administrative Region of China, is closest to a pure capitalist system. However, even in Hong Kong, several types of services, such as mass transportation and utilities, are still provided by the government. Several services (defense, social services, Amtrak, the Tennessee Valley Authority, etc.) in the United States are also provided by the government. The American Credit Crisis of 2008, which was followed by the U.S. taxpayer bail-out of several major private financial and corporate institutions, and recent subsidies for semiconductor chip manufacturing and other sectors at home have enabled the United States to become a less capitalistic and more a mixed economy.

mixed economic system The economic system that exhibits elements of both the capitalist and the command economic systems.

A **mixed economic system** is one that exhibits elements of both the capitalist system and the command system. Not all services (e.g., defense and social welfare) can be provided by the private sector; hence the government plays a crucial role in providing these services, while at the same time procuring goods (fighter aircrafts, naval fleet, ammunition, etc.) from private companies. Not all mixed economies are alike. In some countries, public sector (government-owned or state-owned) enterprises play a much larger role than in others. In the industrialized countries of Europe—for example, France—the government owns (partially or substantially) several companies like Air France, Électricité de France (EDF), and SNCF (the French railroad system). In many developing countries—for example, China and India—several companies in the manufacturing and service (banking) sectors are owned by their governments. The Chinese and Indian governments own several steel, fertilizer, petrochemical, oil and gas, machinery, and electronics firms, as well as services like airlines, railways, and shipping.

The larger the role state enterprises play in an economy, the greater the prospect for economic inefficiency. State enterprises are inherently overstaffed with underperforming employees who have little motivation to work hard or efficiently, since their salaries are generally not tied to productivity. All employees get paid more or less the same, and salaries are normally based on seniority (like in military service)—number of years of service with the state agency. If you have traveled to France or India, you will readily see for yourself how the United States compares with them in terms of efficiency in the production of goods and services although the quality of service has been slipping in the United States as well since the start of the COVID-19 pandemic. Countries that are dominated by private sector enterprises generally exhibit dynamic business and economic growth because of competition. The trend these days in mixed economies of Europe and Asia is to move away from state enterprises to private businesses. This is being achieved through the sale of state enterprises to private entrepreneurs—a process called **privatization**.

privatization The process of selling state enterprises to private entrepreneurs.

As countries privatize state enterprises, their economies are bound to grow faster, and productive employees will become richer. Governments can then focus their attention on providing services like social welfare and defense that generally cannot be provided by private firms. While the mixed economy is bound to stay with us for a very long time, the role of government in running businesses is destined to diminish.

The Transition Economies

In 1989, after years of state control of all productive assets in the Soviet bloc, the Berlin Wall fell, and the Soviet Union broke up into several independent countries. This led to the start of market-oriented reforms in Russia and several former communist economies of Central and Eastern Europe and Central Asia. This move, from central planning to relative capitalism (in the direction of competitive, market-oriented, open trade economics), is called **economic transition** and is aimed at ending the inefficiencies of central planning. Privatizing state-owned enterprises is also designed to free resources and talent that can be used more productively by the private sector, thereby raising the living standards of these people. While economists generally refer to the former Soviet Union countries as transition economies, China in 1978 was the first major economy to embark on the reform from state control to capitalism. China is gradually implementing market-oriented reforms that are introducing profit incentives to rural enterprises and private businesses, liberalizing foreign trade and investment regulations, relaxing state control over most prices, and investing in industrial infrastructure and the education and retraining of its workforce. By encouraging the growth of rural enterprises and not focusing exclusively on the urban industrial sector, China has successfully moved millions of workers off farms and into factories without creating a significant urban crisis. Finally, China's relatively open-door policy has spurred massive foreign direct investment in the country, creating new jobs and linking the Chinese economy with international markets.[6]

economic transition The move from a command economic system to a capitalist economic system (in the direction of competitive, market-oriented economics) that is aimed at ending the inefficiencies of central planning.

As a result, over the 40-year period since 1978, China's economy grew rapidly at an average real rate of 10 percent a year and lifting some 400 million citizens out of poverty to the middle class—an achievement that no other country has accomplished in history. However, in the process, income inequality in China has increased considerably (similar to that of the United States). To prevent potential social unrest, President Xi Jinping of China has chosen to intervene in the market by regulating activities of China's blue-chip technology and other corporations like Alibaba, Tencent, etc., to promote "common prosperity" (maintain high economic growth but reduce income disparity between the rich and low-income earners). At the same time, China's authorities want to avoid "welfarism" that "raises a group of sluggards" who get paid for doing nothing, draining government finances!

The experience of transition economies (China and the former Soviet Union countries) clearly shows the important link between private sector development and economic growth, and the fact that privatized enterprises invariably outperform state-run companies. Research on transition economies shows that firms that started from scratch with new management performed best, followed by newly privatized firms run by outsiders, either local or foreign. Privatized firms managed by insiders were found to be least efficient and productive, but even these firms did better than state enterprises. If transition economies are to grow and develop rapidly, they must ensure that the proper economic environment—institutions that support property rights, the rule of law, a competitive market structure and prices, and attention to consumer demand—is in place.[7] China's leaders believe that the path to stable economic development should be based on evolution and not revolution.

✔ Reality Check

Are you aware of any government-operated business in your city or state? Explain fully.

Production of Goods and Services

LEARNING OBJECTIVE 6
Explain how the factors of production affect the supply of goods and services in an economy.

outputs A wide array of useful goods or services that are either consumed or used for further production in business.

inputs Factors of production (land, labor, capital, and technology), that is, commodities or services that are used by firms in their production processes.

The performance of the U.S. economy is primarily measured in terms of how efficiently goods and services are produced in the country. These goods, such as cars, gasoline, TVs, computers, breakfast cereals, and so on, as well as services like haircutting, dry cleaning, banking, consulting, and transportation, are all called **outputs**. In other words, outputs consist of a wide array of useful goods or services that are either consumed or used for further production. The primary role of businesses, regardless of in which country they are located, is to produce goods or services that consumers need.

Every output requires two or more **inputs**. Economists define inputs as factors of production, that is, commodities or services that are used by firms in their production processes. The final result of the production process is outputs. For example, when we consume French fries, the potatoes, the oil, the frying pot, the oven heat, and the chef's time are all inputs. The crisp fries are the output. Traditionally, factors of production have been divided into four major categories: land (and the natural resources beneath it), labor (of all types), capital (money and capital goods like machinery), and technology.

Land consists of the ground used for agriculture or under factories or railroads (or airports, automobile roads, etc.); natural resources include nonrenewable resources like coal, crude oil, and iron ore and renewable resources like solar and wind energy, and trees used in the production of lumber and paper. Nonrenewable natural resources are provided by nature and are in fixed supply.

entrepreneurs People with initiative who seize opportunities as they see them to get things done or make things happen, generally for profit.

Labor consists of human time spent in productive activities, for example, running a farm, working in an automobile factory, teaching, conducting research, consulting, or running a business. Today's economic environment has led to tremendous specialization of labor. We have engineers and scientists in various disciplines who constantly work on enhancing and inventing new technologies that can be used for improving business processes. We have **entrepreneurs**, people with initiative who seize opportunities as they see them to get things done or make things happen for a profit. While an entrepreneur does not invent things, he or she exploits in novel ways what has already been invented and brings into existence new products or services or a new business or industry. Entrepreneurs are a class of specialized labor not unlike engineers and scientists. Pierre Omidyar changed the face of Internet commerce in 1995 when he created eBay, **www.ebay.com**, the world's first online marketplace. Looking for a way to create an efficient market, he pioneered the auction format for online person-to-person trading. Entrepreneurs, as you can see, play an important role in business creation and development. Jack Ma of China's Alibaba perfected the eBay concept to become the world's largest online marketplace. Other notable entrepreneurs include Jeff Bezos (Amazon), Elon Musk (Tesla and SpaceX), Mark Zuckerberg (Meta), Steve Jobs (Apple), and Sundar Pichai (Google). The supply of human resources is generally not a response to economic conditions but is determined by social and biological factors. Land and labor are generally called primary factors of production because their supplies are not determined by the economic system; that is, neither land nor labor is regarded as an output in the business sense.


Source: Ground Picture/Shutterstock.com.

Tech workers in Austin, Texas, working on the development of electric vehicle batteries.

capital goods Finished goods like machinery and equipment that can be used as inputs for further production of goods and services.

Capital comes in two major forms. First, money (also called financial capital) is utilized to start businesses and run operations (paying salaries and buying raw materials). Sources of money for entrepreneurs are their personal savings, venture capital (Shark!) from investors, loans from banks, and the issuance of bonds (IOUs) and stocks. A second, equally important type of capital (called **capital goods** or physical capital) consists of durable goods manufactured by the economy to produce yet other goods. These durable goods include machinery, construction equipment, trucks, factories, computers, software, and so on, that you see every day. Unlike land and labor, which are primary factors of production, capital goods are produced goods that can be used as inputs for the further production of more goods and services.

Technology makes the production process more efficient through the introduction of better and cheaper ways of getting things done (providing goods and services). The information technology (IT) industry, for example, utilizes fiber-optic cables or wireless telephone and broadband networks to collect, store, process, and relay data, information, and audio and video messages within companies and across national boundaries instantaneously. Developments in information technology and the Internet are something transformative and unique. They are like the birth of electricity, the railroad, the telephone, and the telegraph years ago, each of which brought about massive changes in business operation and economic growth. These marvelous developments are constantly being adapted by business to improve production and supply chain management. Companies like SAP in Germany and Oracle in the United States are world-famous suppliers of software that helps improve planning, production efficiency, and inventory control, thereby bringing down the cost of the final output to the customer.

✔ Reality Check

What factor of production is most abundant in your state? Explain in detail.

Measuring Business Performance

LEARNING OBJECTIVE 7

Discuss how business performance is measured in a capitalist system versus a socialist system and how the objectives of for-profit businesses differ from the objectives of state-owned enterprises and of not-for-profit organizations.

In the free-market system, businesses exist to meet specific consumer needs (either for products or services). In other words, businesses must provide value to customers. At the same time, businesses must be profitable to survive. The exception is not-for-profit organizations like the Public Broadcasting System, **www.pbs.org**, or National Public Radio, **www.npr.org**, whose objectives are to provide balanced reporting and educate people. These and similar not-for-profit organizations depend on contributions from "viewers like you" and on some government and corporate support. In the private sector of the United States as well as most industrialized and industrializing countries of the world, firms are owned either by individuals (like small businesses) or by major investors who have put in a lot of their own money, as well as by people like you and me who have bought company stock. All **investors** who have a financial stake in a business, be it small or large, expect to receive a return on their invested capital; otherwise, they might as well put their money in a bank and earn a small but decent amount of interest. So, how would you as an investor figure out whether you would be better off keeping your money in a bank or investing your savings in a company? To answer this, we need to analyze business performance, which is the subject of discussion in this section. We briefly look into how business performance is narrowly defined and measured and how not-for-profit organizations and different societies evaluate business performance.

investors Those who have a financial stake in a business, small or large, and expect to receive a return on their invested capital.

Maximizing Profit and Shareholder Wealth

All firms, small or big, need to make a profit to remain in business. Profit is the difference between revenue (sales of goods or services) and the cost of the goods or services sold. **Revenue** is the sum of the quantities of all goods and services sold times their price.

revenue The sum of the quantities of all goods or services sold times their price.

$$\text{Revenue} = (\text{quantities of all goods sold}) \times (\text{their price}) + (\text{quantities of all services sold}) \times (\text{their price})$$

Thus, the revenue generated by a McDonald's outlet is the sum of the quantities of all the items that McDonald's sells (Big Macs, Chicken McNuggets, French fries, cola, etc.) times their price (the price of the Big Mac, Chicken McNuggets, French fries, cola, etc.). The cost to the McDonald's outlet includes what the owner of the outlet pays for the various inputs, that is, the buns, burgers, chicken, frozen fries, cooking oil, cola, and so on. In addition, the outlet's cost includes the salaries and benefits paid to its employees, the maintenance cost of the outlet, the rent for space, and the fee (called the franchise fee) paid to McDonald's Corporation for using the McDonald's brand name and the services that McDonald's Corporation provides to the owner of the outlet. When you add up all these costs and subtract the sum from the revenue, you can determine the profit for the

EXHIBIT 1.5 Relationship between Revenue, Expenses, and Profit

Revenue				
Cost of inputs	Wages paid	Rental expenses	Franchise fee	Profit

McDonald's outlet (see Exhibit 1.5). So, if you were considering owning a McDonald's outlet, you could figure out based on the anticipated profit to be generated by the outlet whether you would be better off investing your money in the business or keeping your savings in a bank. Most rational investors who start a business want to generate as much revenue as possible and at the same time want to keep expenses under control. That is, investors want to maximize revenue and minimize expenses. Since profit is the difference between revenue and expenses, what investors want to do is to maximize profit. When revenue is less than costs, the firm incurs a loss.

In large corporations like Ford Motor Company, even the Ford family is unable to come up with the huge investment (for building factories, installing various equipment, maintaining stocks of steel, etc.) needed to run the company. Although Ford may be able to borrow some money from banks to meet the expenses associated with building automobiles, trucks, and so on, banks will lend only a certain amount of money. So, the rest of the required funds will have to come from investors (people with savings) who will purchase stocks issued by Ford Motor Company. While Ford will not be able to guarantee a return (income, or dividends) to investors (called stockholders) on its stocks, Ford's management will try to maximize profit. Part of the profit will be distributed to Ford's stockholders in the form of **dividends**. Thus, the more profit Ford generates, the more dividends the stockholders will likely receive while Ford reinvests some of the remaining profit—called **retained earnings**—into the company to generate additional profit in the future. In essence, what Ford tries to do is to **maximize shareholder wealth** (dividends plus the increase in the stock prices over time). By purchasing Ford Motor Company's stocks, the Ford stockholder puts her or his money and faith in Ford's management. Ford's management believes that its obligation is to maximize shareholder wealth. The greater the dividends that Ford shareholders receive and the higher that Ford stock prices rise, the happier the investors are and the more willing they will be to buy and hold Ford stocks.

dividends The portion of profits distributed to stockholders.

retained earnings The portion of profits not distributed as dividends but reinvested back into the company to generate additional profits in the future.

maximize shareholder wealth Corporate policies that lead to high dividend payments and rising stock prices over a period of time.

Maximizing Stakeholder Wealth

In the United States, employees (labor) at firms and corporations are generally looked on as a factor of production just like land and capital. When the U.S. economy slows or a company is not doing well for various reasons, the U.S. norm is to lay off workers (shed excess labor) to reduce cost until profits improve. Despite unemployment compensation benefits paid by the government, laid-off workers and their families go through tremendous economic and psychological stress and hardship. The Europeans and Japanese do not like the U.S. approach. They believe that the U.S. system of laying off workers is too ruthless (which it is!) since from their point of view, employees are more than mere factors of production—they are humans—and therefore need to be treated better. Many European managers believe in a broader corporate objective than maximizing shareholder wealth. Supported by European public opinion, these business leaders would like to maximize stakeholder wealth and move toward a stakeholder society rather than a purely shareholder society. There is tremendous debate in Europe and Asia, and to a lesser extent in the United States (e.g., Jamie Dimon, CEO of JPMorganChase), on the merits of a **stakeholder company**—one that does not focus exclusively on shareholder wealth maximization and its short-term interests but that takes into consideration the welfare of all its constituents: customers, management, employees, suppliers, and society. While measuring shareholder wealth is relatively straightforward, measuring stakeholder wealth and maximizing it can get a bit difficult. For example, in the latter case, companies are obliged to keep redundant employees and share some of society's cost. Europeans believe

stakeholder company A business that takes into consideration the interests of all its partners, including its customers, management, employees, suppliers, and society.

ETHICS IN BUSINESS

Corporate Profits Versus Corporate Ethics

The U.S. business system focuses on maximizing short-term profits; stock analysts as well as investors continually focus on the quarterly profit performance of companies. Corporate managers (whose salaries and bonuses are often tied to corporate performance) in turn try their best to meet short-term expectations—maximizing corporate profits and boosting stock prices! Recent events, especially in corporate America, have brought the issue of **business ethics** to the forefront. Business ethics deals with questions about whether certain business practices (some of which may be legal) are morally acceptable, especially when they have a detrimental impact on consumers, investors, and/or employees—compromising long-term corporate viability for short-term gain by making false claims related to their product and services or conducting various forms of corporate (especially accounting and financial) shenanigans. For example, in 2022 Elizabeth Holmes, CEO, a dropout of Stanford University, and her former boyfriend Ramesh "Sunny" Balwani, COO, were found guilty on charges of intentionally defrauding investors and patients by making false claims about their start-up, Theranos, whose blood-testing technology that was meant to disrupt America's bloated health-care industry. Balwani was the brain behind deceiving and influencing patients and pharmacies (e.g., Walgreens) about the effectiveness of Theranos's device, which was relatively inexpensive, painless to use, and a quick way of getting blood tested. Holmes, on the other hand, used her charisma and charm (as a female entrepreneur with a deep, assuring voice, generally wearing turtleneck shirts à la Steve Jobs of Apple!) to raise nearly $1 billion from such notable investors as media mogul Rupert Murdoch, Oracle cofounder Larry Ellison, Silicon Valley investor Don Lucas, Walmart's Walton family, and former U.S. Secretary of Education Betsy DeVos. The pair also attracted famous personalities to the Theranos board of directors, including former Secretary of Defense James Mattis, former Secretary of State Henry Kissinger, and former Senator Sam Nunn. At its peak, Theranos was valued at $9 billion, and Balwani's stake was worth around $500 million before an investigative article from the *Wall Street Journal* reported that Theranos technology just did not work, which sent the company stock spiraling down before it collapsed. Theranos's downfall can be attributed to a common thread that has plagued past corporate scandals: unethical behavior of key corporate executives that had been tolerated for years, often with regulators and industry insiders looking the other way. Such corporate scandals are generally the result of executives trying to boost short-term revenues and earnings, thereby artificially inflating their corporation's stock prices and cashing in their equity before the company collapses.

The 2022 verdict of the U.S. District Court in San Jose, California, clearly indicates that Balwani conspired with Holmes on a decade-long scheme to defraud investors, employees, and patients to keep their unviable company afloat. It is interesting to note that investors and board members quite often get impressed by the charisma of corporate leaders by linking charm to competence!

Source: "The Shortcuts to Theranos," *The Economist*, December 11, 2021, p. 58.

QUESTIONS

1. Should the health-care industry be regulated further and supervised more tightly? Or can market forces rectify the situation? Is this a case of a few rotten apples, or is the problem systemic?
2. Why do you think so many well-known U.S. investors and board members of Theranos got blind-sided, especially when compared with the relatively few such cases happening in Europe and Japan?

strongly that in the long term, such a socially responsible company will be better off than businesses that are exclusively based on shareholder wealth creation. In stakeholder-oriented companies, employees are considered more than a factor of production, and they cannot be hired or fired easily. As a comparison of equity, the ratio of salary paid to the chief executive of a company to that of an average factory worker is close to 50:1 in Europe and Japan, while it is close to 400:1 in the United States. As Warren Buffet, the Sage of Omaha, indicated in Berkshire Hathaway's 2003 annual letter (March 7, 2004) to shareholders, "In judging whether corporate America is serious about reforming itself, CEO pay remains the acid test. To date, the results aren't encouraging."

business ethics The principles governing whether certain business practices are morally acceptable, especially when they have a detrimental impact on consumers, investors, or employees.

Minimizing Unemployment and Income Inequalities

In several developing countries of Africa, Asia, the former Soviet bloc, and Latin America, the primary objective of many large companies is to keep people employed. Invariably, these companies are government-owned state enterprises. While many of these state enterprises, especially in Brazil, China, India, Russia, and South Africa, are currently being sold to private entrepreneurs in the process called privatization, a significant number of state enterprises still exist in the Middle East, Central Asia, and Latin America. Most governments consider state enterprises a source of employment generation. As a result, state enterprises tend to be overstaffed, and the employees are invariably underpaid. Also, the productivity of state enterprise employees is generally low. This creates a vicious cycle. Because the employees are poorly paid, they do not work hard. Since they do not work hard (they hardly work in many cases!), **productivity** (dollar output of goods and services per dollar input of labor) is low and they are entitled only to low wages. There is generally a total lack of motivation on the part of these employees and managers to work hard and perform well in government-owned firms, since employees and management are not rewarded on the basis of profits. The tendency of workers and managers alike is to do the minimum needed to get by.

productivity The dollar output of goods and services per dollar input of labor.

A related objective of state enterprises is to minimize income inequalities. In the free enterprise system, anyone with a good business idea can start a firm and operate it within the rule of law. Those with ideas, initiative, and resources can become rich, while those with no ideas, initiative, or resources are likely to be left behind. Thus, in the free-market system, we can see that those who work hard are likely to succeed and earn a decent living, while those who do not work hard may not be well off. Politicians in some countries do not consider this to be appropriate (since the rich seem to get richer and the poor, poorer) and have favored state enterprises, where wage differences between management and factory workers are not large, thereby minimizing income inequalities and social unrest. The drawback of this system is that it focuses too much effort on income redistribution and not much emphasis on work ethic, increasing efficiency and generating profits and economic growth.

Not-for-Profit Organizations

The primary objective of these organizations is to serve society. Since these organizations are not-for-profit, they are exempt from paying corporate taxes. Not-for-profit organizations have an extremely important role to play in an economy. They provide goods and services that would otherwise not be made available and without which society as a whole would be worse off. There are hundreds of local (Boy Scouts and Girl Scouts), state (Adapt of Texas), national (Salvation Army), and international (Catholic Relief Services) not-for-profit organizations that are vital for the well-being of society.

Take educational institutions, for example. Although one may think or feel that these schools or universities are out to make a profit, that is not true. Public schools are funded by taxpayer dollars, and there is a constant challenge for governments to manage within state-allocated budgets. State universities receive some government funding, which is generally not adequate, and universities charge students tuition and fees to cover the cost of instruction, lab equipment, and campus facilities. Universities also use income from endowments (donations from alumni or corporations) to defray some costs. Private universities operate in a similar fashion to public universities. All these institutions try to manage within their budgets, and when there is a surplus (not a profit), those monies are saved for emergencies or for future capital (campus) improvements. There are numerous other national and international not-for-profit charitable organizations. These include the international not-for-profit agencies like UNICEF, Doctors Without Borders, and World Vision. These charities reach out to people who need help and improve their quality of life.

✔ Reality Check

Do you feel that the rich are getting richer and the poor are getting poorer in your country? Why?

Demand for Goods and Services

LEARNING OBJECTIVE 8
Explain the important role consumers play in determining corporate performance and show how businesses try to identify consumer needs.

Firms are in the business of producing goods or providing services for customers. Without customers, businesses will cease to exist and unemployment will increase. Consumers, therefore, are extremely important for business success as well as for the well-being of the country. Approximately 70 percent of the U.S. economic output is based on private consumption. So, when the U.S. consumer curtails her or his spending habits, the demand for goods and services is at once negatively affected and private consumption shrinks; this leads to **inventory**—unsold goods—buildup. When inventory buildup reaches a certain level, businesses cut down production and lay off workers, and the economy contracts.

inventory Unsold goods in stock.

The role of the consumer, regardless of the country under consideration, is paramount for business growth and profitability. Businesses constantly try to identify consumer needs to develop products and services that can be sold profitably.

Measuring Consumer Confidence

Given the crucial role consumers play in an economy, businesses are eager to know how positive consumers feel about themselves and their environment. If consumers feel great about their jobs, their job security, their salaries, and their general home environment, they are likely to spend freely on all types of items, thereby boosting business revenue and economic growth. Government policymakers are always happy to see their economy grow for several simple reasons. Steady economic growth implies that businesses are doing well and are generating profits. When businesses do well, they employ more people and pay more corporate taxes. The resulting high rate of employment in turn generates more income taxes for the government and reduces unemployment benefits and social problems like crime. For these reasons, businesses as well as economists are interested in knowing the level of consumer confidence, that is, how satisfied consumers feel about themselves, the economy, and their spending habits.

A closely watched measure of consumer confidence is the **Consumer Confidence Index**, which is put out monthly by the Conference Board, **www.conference-board.org**, in New York. The Conference Board is a not-for-profit organization that works as a global, independent membership organization serving the public interest. The Consumer Confidence Index is based on the Consumer Confidence Survey, **www.conference-board.org/data/consumerconfidence.cfm**, which samples 5,000 U.S. households monthly. For example, that index decreased to 98.7 in June from 103.2 in May 2022 (1985 = 100). When the index falls, it indicates that consumers are less confident about current business conditions. This implies that consumers may not continue spending, and this in turn could affect business revenues and earnings. A drop in the Consumer Confidence Index sends a message to firms that they should not be optimistic about the immediate business environment and may want to curb investment or expansion plans. Economists get very concerned, since these actions may raise unemployment and reduce corporate profits and income tax revenues. A related index put out by the Conference Board is the Expectations Index, which measures the consumer outlook for the short term. When this index rises, it indicates that, overall, consumers are optimistic about the short-term outlook for the U.S. economy.

Consumer Confidence Index
An indicator that measures the self-assurance of consumers and is crucial in determining consumer spending habits that have a direct impact on business prospects and the economy.

The Consumer Knows Best

Given the fact that businesses depend heavily on consumers for their survival, the questions in every businessperson's mind are, Who is the consumer? Are all consumers alike? Do culture, gender, income, demographics, national boundaries, and so on impact a consumer's purchasing habits and purchasing power? If so, how and why? Properly identifying, understanding, and serving customer needs is key to business success. Regardless of what businesspeople think, it is ultimately the consumer who calls the shots. Quite often businesses come up with a relatively novel product or service, but the consumer may not be ready for it. The consumer may find the product or service to be of little value to him or her, and this may result in that business's failure. The test of business success is in the market, and in the market the consumer rules!

Source: Jacob Lund/Shutterstock.com.

Millennials discussing a new team project for corporate presentation.

Consumer Demographics and Psychographics

The United States is currently the world's largest consumer market. It is also the world's largest economy in nominal terms with one of the lowest unemployment rates. In addition, the United States is the world's largest importer and exporter of goods and services. According to the U.S. Census Bureau, for example, 50.5 percent of the U.S. population of some 332 million in 2021 was female; 75.8 percent white, 18.9 percent Hispanic, 13 percent African American, and 6.1 percent Asian; approximately 5.7 percent of the population is in the under 5-year age group, and 22.2 percent is in the under 18-year age group. Furthermore, currently 16.8 percent of the U.S. population is over 65 years old And the Hispanic population is projected to rise to 24 percent by 2050. What do all these statistics mean to business? Does anyone care? Yes, these statistics reflect the diversity of U.S. consumers and are of great interest to businesses as they try to determine what to produce and for whom. For example, magazine publishers in the United States analyzed this information to come up with such magazines as *Black Enterprise*, *Golf for Women*, *Latina Magazine*, *Seventeen*, and *Sports Illustrated for Kids* to cater precisely to the needs of specific audiences. Among the wealth of statistics available from the Census Bureau is information on where and how the U.S. population is distributed. That information enables businesses to identify the right location for manufacturing and marketing different products and services.

We all know that not all consumers are alike. People have different tastes (and therefore different needs for goods and services), which might depend on various demographic and social characteristics like *gender*, *age*, *race*, *national origin*, *income*, *education*, *employment*, *physical location or residence*, *sexual orientation*, and *marital status*. However, a group of people can be identified who have similar tastes and who for all practical purposes can be lumped together as one of several target groups that businesses may want to cater to. Depending on the type and number of consumers in it, the target group may have a critical mass, a size that makes business viable. A **target group** could be U.S. millennials who, as defined by the Pew Research Center, are those who in 2018 were in the 22-to-37-year age group, and they constitute 73 million of the U.S. population. They have reached the most important age range for economic activity and overtook the baby boomers in number in 2020. Since all millennials have integrated technology into their lives and habits, businesses are scrambling to identify and respond to millennial tastes and spending habits.

target group A population segment whose members have more or less similar consumption habits.

Mercedes Benz cars, for example, have traditionally been purchased by a specific segment of the U.S. population, that is, those with relatively high income and around middle age. Income and age are some of the demographic characteristics that DaimlerBenz uses for **market segmentation**. Mercedes Benz's new cars come loaded with high-tech devises to meet the perceived needs of millennials. Depending on the product or service that is being considered, businesses may include product-specific demographics. **Psychographics**, on the other hand, deals with an analysis and understanding of the consumer's mind to identify likes, dislikes, or preferences and to develop commercials that try to manipulate the recipient's mind to create a desire for certain goods or services. Here businesses try to go across demographics to identify and arouse certain consumer tastes to sell their products, for example, Samsung or Apple smartphones.

market segmentation The breakdown of target consumers into categories on the basis of age, gender, education, ethnic background, or other criteria to determine the products or services that could be made to suit the segments' specific needs.

psychographics The analysis and understanding of the consumer's mind to identify consumer likes, dislikes, or preferences and develop commercials that manipulate the recipient's mind to create a need for certain new goods or services.

Cultural Diversity

Culture plays an extremely important role in business, especially in such functional areas as human resource management and marketing. Domestic and international companies that have been successful in identifying, designing, and implementing strategies that take into consideration cultural differences in their business environments are the ones that are most likely to succeed. Businesses, big and small, are slowly recognizing that to succeed, they must please individual customers of many national origins with many different national cultures.

culture The behavior patterns, beliefs, and institutions that underpin all human activities, explain much of our actions, create an awareness for learning, and vary by social grouping.

The challenge with culture is that it is as easy to grasp as a wet frog. Yet, cultural awareness is paramount to business success. Culture underpins all human activities, explains much of our behaviors, and creates awareness for learning. Cultural differences exist not only between countries but also within them. While it is true that cultural differ-

CASE IN POINT

McDonald's Exits Russia—Goodbye for Now!

McDonald's Corporation is the world's leading global foodservice retailer with more than 39,000 fast-food restaurants in over 100 countries. Approximately 95 percent of McDonald's restaurants worldwide are owned and operated by independent local business owners. The company expects to add over 1,300 new restaurants in 2022 with capital expenditures of approximately $2.1 to $2.3 billion, and it expects an operating profit margin of around 40 percent.

On January 31, 1990, McDonald's opened its first Russian restaurant in Pushkin Square, Moscow. The restaurant ended up having to stay open several hours past its official closing time due to the high demand and served a whopping 30,000 customers on its opening day—a record for the iconic American chain. In fact, McDonald's was opening its very first restaurant in the Soviet Union, becoming one of the few Western companies to breach the Iron Curtain in its final days as it slowly opened to the world. When the restaurant doors opened, bundled-up Muscovites rushed in for their first-ever taste of this alien cuisine: the Big Mac. At that time, a meal at McDonald's cost half a day's wages for an average Russian, but "it's unusual . . . and delicious," one local woman told a CBS News reporter at the opening, after trying her first burger. For a generation of Russians, McDonald's represented their first exposure to capitalism and American culture.

After 32 years of operations in the country, in March 2022, McDonald's halted operations of its company-run restaurants in Russia, which was one of the company's largest international markets. Although some outlets run by franchisees stayed open, the action by the multinational fast-food chain was among the most visible responses by foreign companies to Russia's actions in Ukraine. The humanitarian crisis caused by Russia's invasion of Ukraine on February 24, 2022, and the precipitating unpredictable operating environment, led McDonald's to conclude that continued ownership of the business in Russia was no longer viable, nor was it consistent with McDonald's core values.

On May 16, 2022, McDonald's president and chief executive officer, Chris Kempczinski, said, "We have a long history of establishing deep, local roots wherever the Arches shine. We're exceptionally proud of the 62,000 employees who work in our (Russian) restaurants, along with the hundreds of Russian suppliers who support our business, and our local franchisees. Their dedication and loyalty to McDonald's make today's announcement extremely difficult. However, we have a commitment to our global community and must remain steadfast in our values. And our commitment to our values means that we can no longer keep the Arches shining there (in Russia)."

McDonald's Corporation announced it will exit the Russian market and initiate the process of selling its Russian business. McDonald's exit strategy was to pursue the sale of its entire portfolio of Russia restaurants to a local buyer. The company's exit strategy includes "de-Arching" those restaurants, which entails no longer using the McDonald's name, logo, branding, and menu, though the company will continue to retain its trademarks in Russia. McDonald's priorities include seeking to ensure the employees of McDonald's Russia continue to be paid until the close of any transaction and that employees have future employment with any potential buyer. As a result of its exit from Russia, the company expects to record a $1.2–1.4 billion write-off its net investment in Russia.

In June 2022, McDonald's decided to leave Russia altogether and sold its 850 restaurants to Alexander Guvnor, who held licenses for 25 franchises in Siberia. Guvnor moved fast to reopen the shuttered outlets. Oleg Paroev, the chain's general director, had a goal to open 200 outlets by the end of the month. As part of the business deal, the new owners agreed to retain all 62,000 people employed by McDonald's prior to its exit.

The famous Pushkin Square restaurant reopened under the Russian owner and a new chain name: *Vkusno-i Tochka* (Tasty-period). The logo is different but still evokes the golden arches: a circle and two yellow oblongs, representing a beef patty and French fries. The crowd at the Pushkin Square outlet opening was sizable and lively, but nothing like the turnout for the McDonald's opening in 1990, when people waited in line for hours. At that time, McDonald's had psychological and political resonance beyond hamburgers. "This is a historic place—the flagship of McDonald's," Guvnor told reporters. "I'm sure it will be the flagship for us." Inside, the restaurant resembled a fraternal twin of its former self. There were touchscreens for placing orders and counter workers wearing familiar polo-shirt uniforms. "We're sure that our customers won't notice a difference between us," Paroev said. However, he noted that the company will seek a new soft drinks supplier as it has limited stocks of Coca-Cola.

Sources: "McDonald's to Exit from Russia," May 16, 2022, www.mcdonalds.com; and Natasha Turak, "Goodbye, American Soft Power: McDonald's Exiting Russia After 32 Years Is the End of an Era," May 20, 2022, https://www.cnbc.com/2022/05/20/mcdonalds-exiting-russia-after-32-years-is-the-end-of-an-era.html?&qsearchterm=Natasha%20Turak,%20McDonalds%20exiting%20russia.

QUESTIONS

1. Evaluate McDonald's business performance in Russia. Was the company's decision to exit from Russia correct as far as shareholders are concerned? Explain in detail.
2. What are the benefits to the new Russian owners of Vkusno-i Tochka? Do you think there was any negative impact on the Russian consumer and economy because of McDonald's exit? Explain in detail.

ences between nations are wide and varied, we should not ignore the fact that even people within a country like the United States vary in their beliefs and behavior and they must be treated equitably. As a nation of immigrants, the United States has always accepted people from abroad who meet specific requirements (immediate relatives, refugees, and employment-based immigrants) to settle in the country and to spur economic growth and enrich the national landscape. The United States is truly a multicultural society, an amalgamation of peoples of different ethnic background, religion, and social class all living in one economic environment.

The challenges and opportunities for businesses get more complex when they take into consideration cultural diversity in a global business environment. For example, in a conservative country like Saudi Arabia, McDonald's restaurants have separate service lines for "ladies" and "gentlemen" and provide customized menus (serving McArabia Sandwiches, for example) to reflect local tastes.

The primary role of business is to serve the customer. Unless a business can identify the cultural and demographic background of the consumer, the firm may not be in a position to identify consumer requirements and satisfy that particular need. Depending on their cultural and demographic background, customers like to acquire different types of food, shelter, clothing, and entertainment. With increased globalization, consumer tastes and behavior will change across cultures more rapidly as foreign cultural norms permeate open societies. However, while some cultures may be willing to readily accept and adapt to foreign cultures, others may resist them to maintain their national identity. This is particularly true in the way people dress, eat, and entertain. McDonald's, for example, has tried to adapt its menus to meet the needs of different cultures while maintaining its relatively unique fast-food service quality. Since questions were raised about the nutritional value of its food (in terms of portion size and fat and carbohydrate content), the company has taken major positive steps like revamping its menu and providing calorie content of items to enable consumers to make healthy food choices. Cross-cultural understanding and competency are crucial not only for successful global management and marketing but also for human relationships. Lack of cultural sensitivity can lead to declining profits and stock prices, new-product disasters, and litigation.

Instituting cultural diversity in the workplace can lead to innovation, new-product development, and increased corporate profits. At one time, hiring employees of different backgrounds was considered good corporate citizenship. However, the globalization of business is now making it imperative for firms to have a diverse workforce at all levels to achieve corporate success. Employees of different backgrounds help bring new perspectives on products, services, and markets that otherwise might have gone untapped. Along with diversity come sensitivity to cultural differences and an understanding of what motivates consumers to choose one product over another. Firms can no longer use a "one-size-fits-all" approach in business if they are to be financially viable. In India, with a population of 1.35 billion, Coca-Cola decided to boost profits by reactivating the sale of Limca, a popular Indian lemonade drink that it had acquired, rather than force Coca-Cola down the throats of Indians! Businesses today need employees at all levels to be open to varying ideas and viewpoints, and that can only be brought about by practicing cultural diversity. The success of companies like Apple, Meta, Samsung, Shell, Sony, Tesla, Toyota, VW, Microsoft, GE, Merck, Johnson & Johnson, Procter & Gamble, and so on can be largely attributed to their commitment to and appreciation of cultural and demographic diversity, equity, and inclusion at work and in the marketplace. The key to the success of some of these companies (e.g., Intel, Pfizer, Moderna, Tesla) is their ability to adapt production (with the help of federal grants—corporate welfare!) to quickly develop and deliver successfully goods like COVID-19 vaccines and electric cars to meet national demand.

In the United States, federal laws require organizations to practice non-discriminatory policies regarding personnel recruitment, and this produces a diverse workforce (e.g., visit **www.DiversityInc.com**) in terms of race, sex, and national origin. Texas A&M University, for example, is committed to equal employment opportunity and affirmative action for various minorities, women, veterans, and individuals with disabilities. The university's affirmative action program can be viewed at https://employees.tamu.edu/talent-management/managers/affirmative-action.html on its Human Resources Department home page. The program's objective is to recruit, select, promote, pay, and take all personnel actions on the basis of professional abilities and qualifications. Companies that treated employees unfairly have paid a heavy price. For example, Home Depot agreed to pay $104 million in 1997 to settle a class action suit on behalf of 25,000 women who claimed they were denied promotions because they were female. Coca-Cola and Texaco, now part of ChevronTexaco, each paid well over $100 million to settle race discrimination cases in 2000.

✔ Reality Check

By looking at the businesses around you, would you say that your hometown is culturally diverse?

Measuring Gross National Product, Gross National Income, and Gross Domestic Product

LEARNING OBJECTIVE 9

Discuss why and how national output of goods and services is measured.

Another equally important factor that impacts consumer behavior and business performance is income level, which when measured on a national scale is a country's **gross national product (GNP)**. The GNP is the value of all *final* goods and services produced by a country's factors of production (regardless of where these factors are located) and sold on the market at current prices over a given time, usually a year. The GNP is a summary measure of all goods (e.g., food, clothing, books, gasoline, cars, and so on) and services (e.g., education, consulting, dry cleaning, haircutting, Wi-Fi, and so on) that a country's factors of production can produce. It is also a measure of a country's living standard, including its health status and educational attainment. The output of goods and services is not possible without the help of factor inputs. The expenditures (*income* earned) tied to the employment of each factor—land, labor, capital, and technology—are called **gross national income (GNI)** and are equal to GNP.

Economists generally divide GNP among the four main components for which a country's output of goods and services is purchased. These include

- **Consumption** (the household/personal consumption expenditures of private domestic residents)
- **Investment** (the spending by private firms to build plants and equipment for future production; also known as gross capital formation)
- **Government expenditure** (the amount spent by the government)
- **Net exports** (the amount of goods and services sold overseas less the amount of goods and services bought from abroad)

gross national product (GNP) The value of all final goods and services produced in an economy and measured at current prices over a given time, usually a year.

gross national income (GNI) The expenditures that make up GNP and are equal to the income that the factors of production (land, labor, capital, and technology) receive.

consumption The amount used by private domestic residents.

investment The amount spent by private firms on new plants and equipment for future production and profit.

government expenditure The amount spent by the government.

net exports Exports minus imports of goods and services.

The term *national income accounts* is used to describe this fourfold classification because a country's income, that is, its GNI, in fact equals its GNP. The reason for this equality is that every dollar used to purchase goods or services automatically ends up as somebody's income. A visit to your local hairstylist provides a simple example of how an increase in national output (in services) raises national income by the same amount. The $15 you pay the hairstylist for a haircut represents the market value of the service that he or she provides you, so your visit to the hairstylist raises GNP by $15. But the $15 you pay the hairstylist also raises his or her income by that amount. So national income GNI rises by $15 as well.

Countries these days report **gross domestic product (GDP)** rather than GNP as their primary measure of national economic performance. The GDP measures the total dollar value of all *final* goods and services produced each year *within* a country's borders regardless of who owns the resources (see Exhibit 1.6). For example, a Mexican migrant

gross domestic product (GDP) The total dollar value of all final goods and services produced each year within a country's borders.

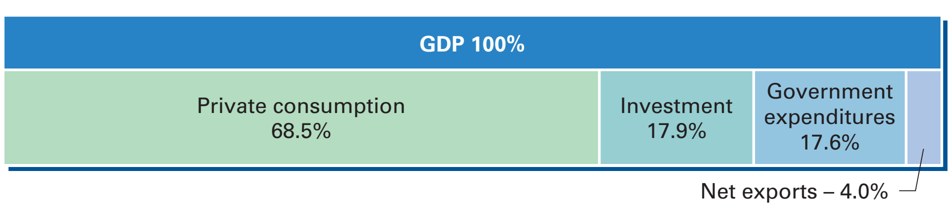


EXHIBIT 1.6 The Components of U.S. GDP, 2021

Note: Figures may not add up to 100% because of rounding error.

Source: US Bureau of Economic Analysis, December 8, 2021.

worker who works on a California farm will increase U.S. GDP, although she or he is not a U.S. citizen. On the other hand, GDP does not include profits earned by U.S. companies *overseas* or the goods and services produced by Americans overseas, since those products and services were produced abroad, not in the United States. Thus, GNP (or GNI) equals GDP plus *net receipts* of factor income from the rest of the world. These receipts are what domestic residents earn on the wealth they hold in other countries less the payments made to foreign owners of wealth located at home.

By breaking down GDP into its components, we could analyze how, for example, consumption is affected by a recession and the important role consumers play in the U.S. economy. This approach (as well as utilizing the *World Development Indicators* as a source) allows for comparisons across countries and provides evidence about why consumers in some countries are rich while others are not. A major drawback of GDP/ GNP/ GNI analysis is that these indicators do not include nonmarket (unpaid) activities such as housework, yard work, or volunteering. Therefore, when a person quits doing housework and hires a maid, or you quit doing your own yard work and hire a landscaper to mow your lawn, GDP, GNP, and GNI will increase.

nominal GNI, GNP, or GDP
Economic output measured in current prices.

real GNI, GNP, or GDP
Economic output measured on an inflation-adjusted basis.

The ultimate measure of economic success is a country's ability to generate a high *level* of and steady *growth* in the output of goods and services, regardless of whether we use the GNP, GNI, or GDP standard. The higher the *level* and faster the *growth rate* of an economy, the richer and better off the consumers of that country are. The GNI, GNP, or GDP can be measured in current prices; this is called **nominal GNI**, **GNP**, or **GDP**. We can also measure GNI, GNP, or GDP on an inflation-adjusted basis; this is called **real GNI**, **GNP**, or **GDP**. Inflation basically moves the general price level up. Economists use a price index number to "deflate" a current, or nominal, GNI, GNP, or GDP to a real GNI, GNP, or GDP, using a certain base year (the International Monetary Fund [IMF] currently uses 2010 as the base year; that is, the GDP deflator is 1.00 for 2010). (See Exhibit 1.7 for details.)

$$\text{Real GDP} = \frac{\text{nominal GDP}}{\text{GDP deflator}}$$

EXHIBIT 1.7 **U.S. Nominal and Real GDP, 2012–2021 (US$ billions)**

Nominal GDP grows faster than real GDP because of inflation.

	Nominal GDP	GDP Deflator	Real GDP
2012	16,254.0	1.040	15,628.8
2013	16,843.2	1.058	15,919.9
2014	17,550.7	1.078	16,280.8
2015	18,206.0	1.089	16,718.1
2016	18,695.1	1.100	16,995.5
2017	19,479.6	1.120	17,392.5
2018	20,527.2	1.147	17,896.4
2019	21,372.6	1.168	18,298.5
2020	20,893.7	1.182	17,676.6
2021	22,996.1	1.231	18,680.8

Source: International Monetary Fund, *International Financial Statistics*, Database 2022.

For example,

$$\text{U.S. real GDP in 2012} = \frac{\text{U.S. nominal GDP in 2012}}{\text{GDP deflator in 2012}} = \frac{\text{U.S. \$16,254.0 billion}}{1.040}$$
$$= \text{U.S. \$15,628.8 billion in 2010 prices (real GDP in 2010 prices)}$$

When financial media like the *Financial Times* or the *Wall Street Journal* report economic growth in the United States or Japan or in any other country, the reference is to *real* GDP growth and not *nominal* GDP growth. Changes in nominal economic growth will include inflation for the period under consideration. Nominal GDP growth rates will provide a distorted view of GDP growth, especially for countries with high inflation rates.

Business Cycles

The up and downswings in real GNI, GNP, or GDP levels over time are called **business cycles**. These swings in real national output are not uniform or timely, and often they are erratic. The long economic boom of the 1990s in the United States made some people think that the business cycle was dead, but the collapse of the dotcom and tech companies in 2001 and the 2008 credit crisis followed by COVID-19 proved otherwise. Business cycles are a regular feature of the capitalist system, but over the long run, real output always tends to show a steady increase. During the upswing, or expansion phase, output, employment, and investment all tend to rise, indicating a period of prosperity. Inflation, especially in the later stages of an economic upswing, tends to accelerate before the economy peaks (firms operate at close to full capacity). The country then begins the contraction phase when output, employment, investment, and inflation begin to fall, reflecting a period of hard times before return to normalcy. The economy must reach the bottom, or trough, before a new cycle of expansion can begin. Economists have been studying—by establishing the causal linkages among various economic activities—business cycles for a long time to identify turning points so that appropriate policies could be implemented to prevent the boom-and-bust periods and smooth out the cycles. This has not been easy, especially since the turning points are apparent only after the fact.

business cycles The up- and downswings in real GNI, GNP, or GDP levels over time that are a regular feature of the capitalist system.

✔ Reality Check
Explain what companies in your area are involved in the export of goods or services?

LEARNING OBJECTIVE 10
Evaluate the impact of the digital revolution on businesses, governments, and societies.

digital era The period of transformation within our lifestyle to make the Internet and related technologies a part of our everyday lives.

bandwidth The amount of data and other information that can be transferred in a second via the Internet.

The Digital Era

What is the **digital era**? Innovations in information technology (IT—computers, software, telecommunications, and the Internet) are radically changing the way people live, communicate, and work. You have probably noticed that essentially everything we do in our daily lives, at home, at school, at play, and at work, is going through fundamental change especially since the onset of the pandemic in early 2020. This period of transformation and resilience—adjusting our lifestyle to make the Internet and related technologies like Zoom and social media a part of our everyday lives—is called the digital era. While some of us like a slow pace of change, today's realities are different. New information technologies, of which the Internet is by far the most publicly visible form, are turning the world upside down as access to the technology spreads rapidly around the globe. The capacity and speed of communications networks (5G and 6G) have increased tremendously. As **bandwidth** (the amount of data and other information that can be transferred in a second over the Internet) expands and as communications costs fall, more and more computers/cell phones (and people) will be linked together. The benefits of online communication will increase exponentially with the number of such connections. Increasingly, as advanced networks take

Source: SDV Photography/Shutterstock.com.

Farmer examining field crops while talking on a smartphone and negotiating price with the wholesaler in Mumbai, India.

hold, they will reshape the way people (all over the world) live, entertain, communicate, and work. The fact is, those same technological changes that are transforming the business world are also revolutionizing the way government does its business, as well as the nature of our own public life.

E-Business

To understand why and how organizations in our economic system are profoundly affected by the IT revolution, we first need to examine the enormous impact of the digital economy on business.

Internet-worked technologies are spawning new business models that are radically changing the basic operating structure in firms that have served the marketplace well for decades. For example, you can purchase music, videos, books, and a whole variety of things online from your home computer or smartphone without having to visit a retail store. A whole set of companies like Alibaba, Amazon, and eBay have entered the business scene to cater to such needs. The value of IT and the Internet lies in their capacity to store, retrieve, analyze, and communicate information instantly, anywhere, at negligible cost. If IT and the Internet are to be placed in the same league as previous technological revolutions (like the Industrial Revolution and the introduction of the railroad system in particular), three major questions must be addressed:[8]

- How radically does the technology change day-to-day life?
- How much does it require businesses to reorganize their operations to become more consumer-friendly and efficient?
- What is the impact of IT on conducting business across the whole economy, either by allowing existing products and services to be made or delivered more efficiently or by creating entirely new products and services?

Around the globe, commercial enterprises are scrambling to avoid being left behind in terms of efficiency as suppliers and customers latch on to Internet-related ways of doing business. Today, by virtue of Internet-worked communications, the transaction costs of many business activities (buying, selling, sourcing) are falling close to zero as the reach and speed of communications technologies increase exponentially and tools become more robust. E-commerce is only the tip of the iceberg that is remaking the rules of business. Several key trends are emerging.[9]

1. Companies are being transformed on a massive scale. Established businesses are undergoing a radical overhaul in strategy, structure, and process to meet the needs of the digital economy. For example, almost all automobile dealerships in the United States have introduced Internet sales managers, whose role is to quote a price upfront over the Internet to customers who are seeking to buy specific automobiles and to have a no-hassle buying experience.
2. Customers are becoming smarter and more demanding. With the vast amount of information readily available to them, for example, via smartphones, and with their improved ability to share knowledge through social media like Pinterest, consumers are empowered as never before. Consumers expect—even demand—the customization of goods and services to meet their individual needs, and they want it right away. Again, in the automobile industry, several companies like Carvana or Autobytel, **www.autobytel.com**, have evolved. Consumers can sit by a computer terminal and connect with Carvana or Autobytel to research, buy, or sell automobiles on the basis of customized specifications.
3. Business is becoming nimbler. More than ever before, agility and flexibility drive competitive advantage in business. Authoritarian management structures and bureaucratic decision-making processes—in large or small businesses—are all likely to suffer in the digital economy. For example, Samsung Electronics' manufacturing philosophy is based on a system of flexible production, which enables the company to dominate the cell phone market. Samsung can maintain very low inventories,

offer attractive prices, and also adjust production to changing consumer demand (by utilizing algorithms), along with the constant introduction of new and powerful smartphones (and related components).

4. Knowledge is the key asset. The abundance of information that is stored in the cloud and the speed of communication imply that innovation based on this knowledge and speed will be the key to business success. Because of its quality higher-education system, India has an abundant supply of talented IT professionals who can provide world-class IT services at competitive rates. Several Indian companies like Tata Consulting Services, Infosys, and Wipro have successfully utilized their IT and software expertise along with their knowledge of U.S. corporate needs to attract outsourcing business to India. Companies in the United States will be forced to compete by focusing attention on developing next-generation industries in AI, biotechnology, nanotechnology, and digital media.
5. Transparency and openness are crucial for business success. Increasingly, customers and markets demand openness (as opposed to secrecy and a strong emphasis on turf protection) in company culture and transparency in company information (especially accounting and financial). As companies move into the digital era, they discover a competitive advantage in making information and knowledge available to their networked partners. In the airline industry, for example, special discounted fares were in the past disclosed only to travel agents, who charged a fee to the customer. Now, discount fares are made readily available on the airline's website or with online travel services like **Travelocity.com**, **Orbitz.com**, **Cheapfares.com**, and **Expedia.com** for easy access by all customers.

In the emerging business models, success will be achieved by those businesses that involve their suppliers, their infrastructure providers, and—perhaps most importantly—their customers in a network in which they can build value together. The idea of partnership is very real in the new e-business world.[10]

Within the e-business environment, there are several specialized sub-e-businesses that deal with certain segments of the economy. Most customers, students in particular, have quite a bit of experience purchasing goods (like CDs, books, stereos, etc.) directly from online retailers like Amazon.com, **www.amazon.com**. Transactions between Amazon .com (the business) and you (the customer) are called **B2C** (business-to-consumer) e-commerce. Similarly, when Amazon.com (the business) purchases this textbook from Academic Media Solutions (this book's publisher) and sells it to you, the transaction between Amazon.com and Academic Media Solutions is called **B2B** (business-to-business) e-commerce. By improving the flow, accuracy, and timeliness of information, secure Internet-enabled systems provide greater transparency and efficiency at all points along the supply chain (Exhibit 1.8). Simply put, the Internet is a continuation of technological improvements that deliver information faster and cheaper, reduce search and transaction costs in online markets, and improve the management of product transportation and inventories. These savings come from both cheaper information and cheaper inputs (through increased competition).[11]

B2C Business-to-consumer electronic commerce.

B2B Business-to-business electronic commerce.

The Internet is of tremendous importance, but it is only a small segment of a nation's economic output. However, the fact that the Internet is important does not imply that it must be profitable. The bursting of the dotcom bubble in 2000 clearly exposed the common misconception that importance equals profitability.[12] As we have noted, there are many similarities between the IT-enabled technologies (especially fiber-optic cable and related business) of 2000 and the U.S. railway mania of the 1870s. In the 1870s, would-be rail millionaires raised vast sums of money on the stock market to finance proposed railway lines by misleading investors on their companies' business prospects. Most railway companies never paid a penny to shareholders, and many went bust (just like Global Crossings, WorldCom, and the dotcoms of the early 2000s in the United States), largely because irrational exuberance and overinvestment created excess capacity. Even so, the railways brought huge economic benefits to the U.S. economy long after their share prices crashed. The lesson is that although the IT and Internet bubbles burst in 2000, these may

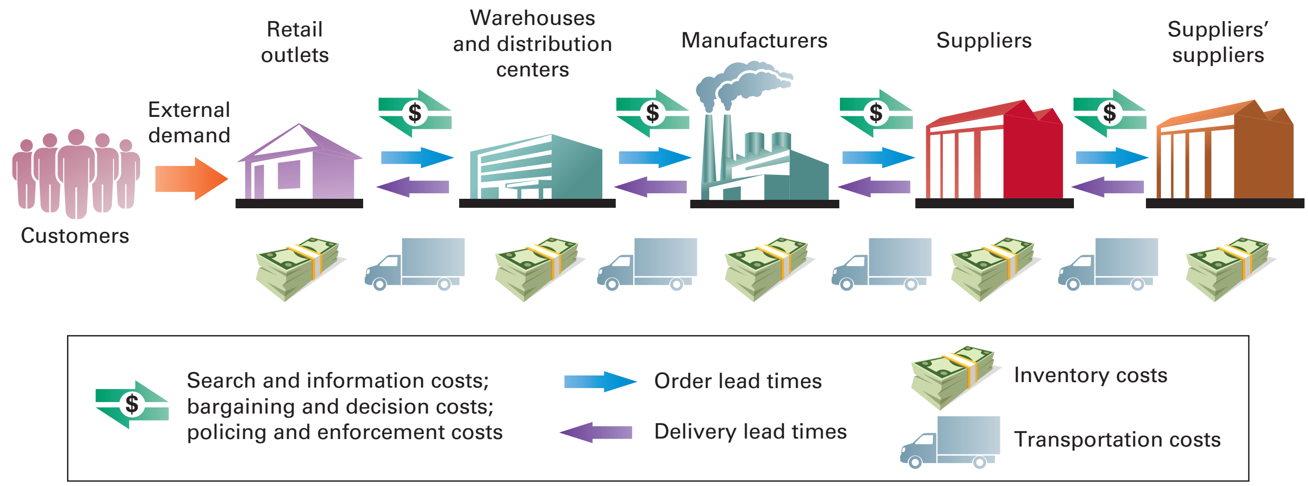


EXHIBIT 1.8 The Supply Chain

Source: Based on Thomas F. Siems, "B2B E-Commerce: Why the New Economy Lives," *Southwest Economy*, Federal Reserve Bank of Dallas.

still produce long-term economic gains. Many investors, however, will have lost their shirts in the bargain! It is a sobering thought that 99 percent of the 5,000 railway companies that once existed in the United States are no longer around. The same is true of 2,000 car firms that once existed in the United States. According to a study by investment bankers Goldman Sachs, profits and share prices of the early electricity firms in the United States were disappointing, despite the industry's profound effect on the economy.[13]

Despite the collapse of many IT and dotcom firms and the failure of many e-marketplaces, the fundamentals behind B2B e-commerce remain strong. A major risk that has emerged since the COVID-19 pandemic, in B2B e-commerce is the impact of production disruption along the supply chain. While efficiency improvements and cost savings achieved through B2B e-commerce have already led to higher productivity growth and lower costs and prices, the ultimate robustness and efficiency of B2B e-commerce depends on the strength of the weakest link in the B2B supply chain. Trade sanctions imposed on Russia following the country's special military operations/invasion of Ukraine and Russia's subsequent trade retaliation are a serious cause for concern since B2B and B2C e-commerce will be critically disrupted, leading to increased inefficiencies and rising costs along the value chain. While most of the efficiency loss will occur between businesses, the greatest long-term losers of B2B e-commerce will be the consumers, who will have to pay higher prices and witness lower living standards.

✔ Reality Check

Explain how the Internet impacts your daily life.

Careers in Business

Just as the study of business is fascinating, so are careers in business, and they are as varied as the topics of study and as rewarding as the study itself. Successful completion of an undergraduate degree in business opens a world of challenges and opportunities for motivated graduates. Careers in business are well-paying, especially in countries that practice the free enterprise system. Professional opportunities for business graduates occur in the private, public, and not-for-profit sectors of an economy.

In the private sector, careers can be developed in publicly held corporations, in privately held businesses, or in small businesses as an entrepreneur. In the public and not-for-profit sectors, career opportunities exist in federal, state, and local government agencies; in not-for-profit organizations or nongovernment organizations (NGOs); and in colleges and universities. As you can see, business careers span the whole spectrum—domestic and international as well as public and private. Yet, for those of you who are enterprising and those who crave personal and financial freedom, starting a small business with all its challenges may provide you with the greatest chance for fulfilling the dream of doing what you want and achieving financial independence. However, starting your own business, one that meets your long-term goals and consumer demand, calls for hard work and dedication. Your success can be measured by the personal freedom, financial well-being, and job satisfaction that come with being an entrepreneur.

At the end of each chapter of this text, there is a brief write-up on career opportunities in a functional area of business (accounting, consulting, finance, information systems, international business, management, and marketing) considered in that chapter. For those of you who would enjoy working for large corporations like Apple, Amazon, Google, IBM, Ford, McDonald's, Samsung, Shell, and so on, either domestically or internationally, the first thing you may want to do is to identify the industry that interests you. The 500 largest U.S. corporations are called the *Fortune 500* companies and the list is published by *Fortune* magazine each year. If you are interested in working for any of the world's largest 500 corporations, you may want to investigate the *Financial Times Global 500*, which is published by the *Financial Times* newspaper of London. Details of the activities of all these companies can be found on their corporate websites, and most of them also list career opportunities there as well. Major privately held businesses, although few (e.g., Bechtel, **www.bechtel.com**), also have their own websites that you can surf to identify job opportunities. Not-for-profit organizations, domestic and international, offer challenging opportunities for business graduates as well. Organizations like the Red Cross, the United Way, and CARE offer interesting and fulfilling business career opportunities. International institutions like the United Nations and the World Bank Group offer global career opportunities with attractive (income tax free) salaries; however, the work environment can be quite demanding, especially when one works overseas. Finally, federal, state, and local governments also offer interesting and stable career opportunities. Since government agencies are not driven by profits or competition, they generally tend not to lay off employees. However, while careers in government do offer job security, salary levels may not match those of the private sector.

There are numerous websites that focus on business careers. One site that you may want to visit is indeed.com, which has a number of very useful links for careers in business.

Summary

In this introductory chapter, the objective is to acquaint you with the basic concepts of business operations.

LEARNING OBJECTIVE 1

Identify the three major factors that impact business today and discuss the roles of for-profit and not-for-profit organizations in an economy.

The three major issues that are significantly impacting business today, which are the themes of this textbook, are *globalization*, *technology*, and *ethics*. As more countries adopt open trading systems, business is becoming increasingly global in nature. Rapid advances in information technology and the Internet are also encouraging the growth of new business and changing the way business is done. Finally, firms must be ethically managed if they are to survive and deliver value to investors and customers alike in the long term. The primary role of business is to create value for the customer and meet the consumer's unmet needs in a profitable manner. If a firm is not profitable, it will not be able to remain in business. However, not all firms have a profit motive. The primary objective of not-for-profit organizations like educational institutions and charitable organizations is to serve the public. Even not-for-profit organizations need to cover costs, or they will be forced to shrink or close operations. The two other major elements are technology and ethics. Advances in technology have moved the United States from an agrarian to a manufacturing to a service and now to a knowledge-based economy. The future of U.S. business will be heavily influenced by the successful retraining of a diligent workforce and the evolution of its knowledge workers and by how ethically its managers function in the global economy.

LEARNING OBJECTIVE 2

Summarize the evolution of business in the United States and explain the key issues that influence its outlook for the future.

The evolution of business in the United States can be traced from the time when the first settlers from Europe crossed the Atlantic Ocean. The initial business climate largely reflected a free-market, or laissez-faire, system, coupled with the availability of abundant land (and natural resources) and a constant and growing inflow of labor and capital, in the beginning from Europe. The Industrial Revolution

(1815–1875) transformed the United States from an agrarian economy to an industrial giant that fostered the growth of the factory system, which involved efficient mass production of standardized products under one roof. Business prospects accelerated with the introduction of the railroad (1875–1913), which led to the westward (coast-to-coast) expansion of the United States and increased the need for goods and services. This was also an era of mergers and acquisitions that resulted in the growth of huge companies, which dominated the U.S. market. Public concern over monopoly profits and pricing enabled the introduction of antitrust policies to curb anticompetitive business practices. A new era (1913–1944) of manufacturing began in 1913 when the Ford Motor Company initiated assembly-line manufacturing using scientific management techniques. Finally, at the end of World War II, the United States and other major nations of the world saw the need to work together to increase trade and investment among countries as a way to propel global business growth. Several international organizations were set with U.S. leadership to facilitate the process, and this started the globalization era—the first major element impacting the outlook for U.S. business. A new era of reimagining globalization commenced with the China trade war initiated by the Trump administration in 2018 that was reinforced by the COVID-19–related supply chain realignments and trade/investment embargo, followed by retaliation related to Russia's special military operation/invasion of Ukraine. Globalization has now stalled as countries try to align themselves based on common national interest and businesses try to navigate the new multipolar world economic order.

LEARNING OBJECTIVE 3

Explain the fundamental features of the free enterprise, or capitalist, system that make it efficient and dynamic.

The free-market system, also called the laissez-faire or capitalist system, is based on private property rights, the pursuit of profits, and the freedom to choose. The system espouses two major principles. First, it calls for minimum government intervention in the marketplace; that is, entrepreneurs should be allowed to participate in any commercial venture they see fit with ease of entry into and exit out of the industry. Since entrepreneurs take a risk by investing their time and resources to develop business and profits, the role of government is to ensure that these enterprises do not get involved in illegal (drugs, money laundering, environmental pollution, employee discrimination) or anticompetitive activities. Second, the free-market system operates on the basis of supply and demand, where consumers are the source of demand and producers are the source of supply. In the marketplace, supply and demand interact to determine the price of goods and services. The free-market system is efficient because supply will always (in the medium term) equal demand and there will be no surplus or shortage. In the short term, if there is a surplus (supply exceeding demand), price will fall until the surplus vanishes. Similarly, if there is a shortage (demand exceeding supply), price will rise until the shortage vanishes. From this discussion, it is clear that the free-market system is both efficient and dynamic.

LEARNING OBJECTIVE 4

Discuss the meaning of* market structure *and explain why most industries fall under the banner of monopolistic competition.

Market structure describes the level of competition (number of producers of goods or services) within an industry. In the free enterprise system, there are four different forms of market structure: pure competition, monopolistic competition, oligopoly, and monopoly. In pure competition there are several producers of identical products; in monopolistic competition there are several producers of similar (differentiated or not identical) products; in oligopoly there are few producers of similar products who supply a significant share of the market demand; and in monopoly there is only one producer who supplies the whole market. Producers have an influence over prices, depending on the level of competition in the industry. The monopolist has the power to set market prices, while a producer under pure competition will not be able to influence market prices at all. In the real world, most of the goods and services that are produced are not identical; they are similar, and that is the reason why most industries fall in the category of monopolistic competition. While pure competition is best for society, in practice, firm concentration ratios (especially in the United States) seem to indicate that most industries fall within the monopolistic competition framework.

LEARNING OBJECTIVE 5

Discuss the rationale for countries wanting to choose other forms (rather than capitalism) of economic systems and explain what direction most countries are moving toward.

Apart from the free-market system, the other major economic systems today are the command, or planned, economic system; the mixed economic system; and the transition economic system. In the command economic system, the government plans the production of goods and services based on national goals and an elaborate analysis of sources and uses of resources available to the domestic economy. The government's objectives are to utilize as many domestic resources as possible, employ whoever is willing to work to solve unemployment and poverty, and minimize income inequality among workers by diminishing wage differentials. In so doing it provides little choice to workers about where to work and what type of work they can undertake. The command economic system is based on the elimination of wasteful conspicuous consumption. The government decides how much of the goods and services are produced, what consumers can purchase, and at what prices. While the command economic system seeks to minimize the exploitation of workers, it does so at great expense to efficiency and consumer choice.

A mixed economic system is one that exhibits elements of both the capitalist and the planned (or command) systems. Not all services (e.g., defense, infrastructure, and social welfare) can or will be provided in a purely capitalist system; in the mixed economic system the government plays a crucial role in providing these basic services while at the same time procuring goods (fighter aircraft, naval fleets, ammunition, etc.) from private companies. The trend these days in mixed economies is to gradually move away from state enterprises to private sector-oriented businesses. This is being achieved through the sale of state enterprises to private entrepreneurs—a process called privatization. In 1989, after years of state control of all productive assets, the Soviet Union broke up. This started market-oriented reforms in Russia and the former communist economies of Central and Eastern Europe and Central Asia. The move from central planning to market-oriented, open trade economies is called economic transition and is aimed at ending the inefficiencies of central planning.

LEARNING OBJECTIVE 6

Explain how the factors of production affect the supply of goods and services in an economy.

Every output of goods and services requires two or more inputs. Economists define inputs as factors of production that are used by firms in their production processes. Traditionally, the factors of production have been divided into four major categories. First there is land and the natural resources beneath it. The quality of the land and the resources beneath it determine how productive it can be. Second is labor, which consists of human time spent in productive activities. Entrepreneurs play an important role in business creation and development. Third is capital, which comes in two major forms: money that is utilized to set up a business and pay for its operation (paying salaries and buying raw materials) and durable goods like machinery that are produced by the economy in order to make yet other goods. Finally, there is technology, which makes the production process more efficient through the introduction of better and cheaper ways of getting things done.

LEARNING OBJECTIVE 7

Discuss how business performance is measured in a capitalist system versus a socialist system and how the objectives of for-profit businesses differ from the objectives of state-owned enterprises and of not-for-profit organizations.

In the free-market system, businesses exist to meet specific consumer needs and to maximize profits. In addition, firms try to maximize shareholder wealth (dividends plus increase in stock prices) over time. Many socialist managers believe in a broader corporate objective than just maximizing shareholder wealth. These business leaders would like to maximize stakeholder wealth, which encompasses the welfare of all a business's constituents: customers, management, employees, suppliers, and society.

In several developing countries, governments consider state enterprises a source of employment generation. A related objective of these governments is to minimize income inequalities. In state enterprises, most employees are paid relatively the same.

The primary objective of not-for-profit organizations is to serve society. They provide goods and services that would otherwise not be made available and without which society as a whole would be worse off.

LEARNING OBJECTIVE 8

Explain the important role consumers play in determining corporate performance and show how businesses try to identify consumer needs.

Firms are in the business of providing goods and services to customers for profit. Without customers, businesses will cease to exist. Businesses constantly try to identify consumer needs to develop products and services that can be sold profitably. Given the crucial role consumers play in an economy, businesses are eager to know how well consumers feel about themselves and their environment. Businesses also spend significant amounts of money to research and analyze consumer cultural diversity, demographics, and psychographics to identify the needs of specific consumer groups and to study the minds of consumers to influence their perception of those needs.

LEARNING OBJECTIVE 9

Discuss why and how national output of goods and services is measured.

An important factor that impacts business performance is income level, which when measured on a national scale is a country's gross national product (GNP). The GNP is the value of all *final* goods and services produced by a country's factors of production (regardless of where these factors are located) and sold on the market at current prices over a given time, usually a year. It is also a measure of a country's living standard, including its health status and educational attainment. By breaking GNP down into its components, we could analyze how, for example, consumption is affected by a recession and the importance of the role consumers play in an economy. The higher the *level* and faster the *growth rate* of an economy, the richer and better off the consumers of that country are.

LEARNING OBJECTIVE 10

Evaluate the impact of the digital revolution on businesses, governments, and societies.

Innovations in information technology (IT—computers/cell phones, software, telecommunications, and the Internet) are radically changing the way people live, communicate, and work. This period of transformation—adjusting our lifestyle to make the Internet and related technologies a part of our everyday lives—is called the digital era. Information technologies, of which the Internet is by far the most publicly visible form, are turning the world upside down as access to the technologies spreads rapidly around the globe. These technologies are having an enormous impact on business, spawning new business models that are radically changing the basic operating structure in firms that have served the marketplace well for decades. Several key trends are emerging: Companies are being transformed on a massive scale; customers are becoming smarter and more demanding; business is becoming more nimble; knowledge is becoming a key asset; and transparency and openness are becoming crucial for business success. In the emerging business models, success will be achieved by those businesses that involve their suppliers, their infrastructure providers, and—perhaps most importantly—their customers in a network where they can build value together.

The Internet and related technologies are not only here to stay; they will also play an extremely important role as an engine of economic growth and development in countries. The key issue is how fast Internet and related technologies diffuse across national boundaries from developed to developing countries. With information technology advancing in leaps and bounds, and the price of semiconductor chips and software falling all the time, developing countries that have just started investing in IT are obtaining a lot more for each dollar invested in this technology than did countries that invested earlier. The impact of these technologies on education, family planning, and health care, as well as business, in developing countries is remarkable. The Internet will help bridge the gap between the developed and developing countries, but the latter will need to keep their markets open and allow new technologies to come in while at the same time implementing reforms that raise the level of education in their countries.

The success of Internet and related technologies depends on how effectively and widely these technologies can be put to use by businesses to boost efficiency and growth. Countries with open economic and political systems will see big gains overall. The IT industry's rapid growth in any country will have to go hand in hand with minimal government controls and regulations.

Key Terms

Antitrust policies (p. 8)
B2B (p. 33)
B2C (p. 33)
Bandwidth (p. 31)
Barriers to competition (p. 16)
Business cycles (p. 31)
Business ethics (p. 23)
Businesses (p. 5)
Capital goods (p. 20)
Capitalism (p. 11)
Command, or planned, economic system (p. 17)
Consumer Confidence Index (p. 25)
Consumption (p. 29)
Culture (p. 26)
Demand curve (p. 12)
Digital era (p. 31)
Dividends (p. 22)
Economic resources (p. 11)
Economic transition (p. 19)
Entrepreneurs (p. 20)
Factory system (p. 8)
Firm concentration ratios (p. 15)
Free-market system (p. 12)
Globalization (p. 9)
Government expenditure (p. 29)
Gross domestic product (GDP) (p. 29)
Gross national income (GNI) (p. 29)
Gross national product (GNP) (p. 29)
Imperfect competition (p. 15)
Inputs (p. 20)
Inventory (p. 24)
Investment (p. 29)
Investors (p. 21)
Knowledge workers (p. 10)
Laissez faire (p. 8)
Licensing (p. 16)
Market clearing, or equilibrium, price (p. 13)
Market domination (p. 8)
Market segmentation (p. 26)
Market structure (p. 15)
Maximize shareholder wealth (p. 22)
Mixed economic system (p. 18)
Monopoly (p. 15)
Net exports (p. 29)
New economy (p. 10)
Nominal GNI, GNP, or GDP (p. 30)
Not-for-profit organizations (p. 5)
Oligopoly (p. 16)
Outputs (p. 20)
Patents (p. 16)
Price elastic demand (p. 12)
Price elastic supply (p. 13)
Price inelastic demand (p. 12)
Price inelastic supply (p. 13)
Privatization (p. 19)
Product life cycle (p. 15)
Product differentiation (p. 16)
Productivity (p. 24)
Profit (p. 5)
Psychographics (p. 26)
Purchasing power parity (PPP) (p. 44)
Pure competition (p. 15)
Real GNI, GNP, or GDP (p. 30)
Retained earnings (p. 22)
Revenue (p. 21)
Risk (p. 6)
Shortage (p. 14)
Specialization of labor (p. 8)
Stakeholder company (p. 22)
State enterprises (p. 18)

Supply curve (p. 13)	Target group (p. 26)	Theory or law of demand (p. 12)
Surplus (p. 14)	Tariffs (p. 16)	Theory or law of supply (p. 13)

Chapter Questions

1. What is profit? How might you try to improve profits if your company is not doing as well as you think it should?
2. Historically, business evolved in the United States through five distinct periods. List the periods and mention one or two key factors that influenced business development during each. Pick one of the periods and explain in detail what type of business development took place then.
3. What is globalization, and what are the origins and effects of globalization on U.S. business?
4. What is capitalism? How are resources allocated in a free-market system? Is this an efficient system for business? Is the United States a purely capitalist country?
5. Why is a "pure competition" market structure best for consumers and society alike? Is it good for business as well?
6. What is a monopoly, and why are consumers and governments opposed to having monopolies in their economies?
7. What are the major flaws of the command economic system? Explain how this system essentially led to the downfall of economies like the Soviet Union.
8. Although many countries claim to be capitalist, none of the countries practice pure capitalism. Why? So, what system do the majority of countries practice? Where do the transition economies fit in the scheme of things?
9. Explain what the major factors of production are. Which factor do you think will play a crucial role in the United States' business future, and why?
10. Compare shareholder wealth maximization with stakeholder wealth maximization. Which approach do you prefer, and why?
11. What are the pros and cons of keeping state-owned enterprises? Would you suggest that all state-owned enterprises be privatized? Why?
12. Not-for-profit organizations play extremely important roles in countries. Pick a not-for-profit organization that you are familiar with and determine its primary objectives, organization, and recent performance.
13. Culture's role in business is extremely important, both domestically and internationally. Identify a product that you use or see every day and trace the role of culture in its design, development, and promotion (advertising).
14. What are the four major components of GDP? Which component drives U.S. economic growth, and why? What is the "bellwether" indicator that businesses closely watch to determine the outlook for their industry?
15. Pick any Latin American country and develop a table like Exhibit 1.7. Graph nominal and real GDP over time for that country. How does the country's real GDP compare with its nominal GDP, and why?
16. Explain and analyze the impact of the Internet on business.
17. We have seen a number of e-businesses come and go. Why do you think that some of these companies failed? Do you see any challenges that e-commerce is likely to face? How may they be overcome?

Interpreting Business News

1. Business newspapers such as the *Financial Times* and the *Wall Street Journal* may at times state that "Consumer confidence is at [say] a 5-year low: Signs of crumbling faith in the U.S. economy fuel prospect for interest rate cut by Fed." How will a cut in interest rates help businesses, consumers, and the U.S. economy in general?
2. Because business is global, you will come across reports from companies indicating that they anticipate rising sales revenue globally but at the same time expect profits to decline. What do you think is going on in the marketplace?
3. On several occasions, the Federal Reserve Bank chair has expressed confidence in U.S. productivity growth because of rising corporate spending on technology. What does productivity growth mean? How does technology spending by companies help productivity growth?

Web Assignments

1. Visit McDonald's website, **www.mcdonalds.com**, surf that website, and go to some of the company's country sites and study their menus. What can you say about McDonald's menus in foreign countries? Pick a

particular non-U.S. and non-European country where McDonald's does business and explain that country's menu from a cultural perspective.
2. Visit Coca-Cola's home page, **www.coca-cola.com**, select a foreign brand product Coca-Cola has acquired, and write a one-page (double-spaced) report on that product. Did you know that Coca-Cola owns and sells many foreign brands that you have never heard of in the United States?
3. The *Economic Report of the President*, which is an annual report on the state of the U.S. economy, is prepared by the President's Council of Economic Advisors and delivered by the president to the U.S. Congress. It is an extremely important document with a lot of facts and figures. Thanks to the Internet, issues of this document are now available on the Web at **https://www.govinfo.gov/app/collection/erp**. Pick the section that deals with the United States in the international economy. How would you determine that the U.S. economy is integrated into the rest of the world?
4. Visit Tesla's home page, **www.tesla.com**, which shows how diverse that company is. Where is Tesla's corporate headquarters? Visit its corporate site and write a one-page (double-spaced) report on Tesla's corporate vision and how the company plans to achieve it. What are the types of consumers most important to Tesla and why?
5. Visit Shell's global home page at **www.shell.com**. What is Shell's line of business? Were you surprised to learn about that company's national origin? What is Shell trying to do on the climate change front to make the company greener?

Portfolio Projects

Exploring Your Own Case in Point

Throughout this text you will find many examples of real companies to help illustrate how the concepts you are learning are applied in real business situations. In particular, we will follow three globalized companies—Samsung, McDonald's, and Shell—in detail through the Case in Point boxed features. The Portfolio Project at the end of every chapter takes that Case in Point concept to the next step by helping you explore a company of your own choosing (e.g., Airbnb, Carvana, Dropbox, Facebook, Google, Instagram, Lyft, Monster.com, Netflix, Shake Shack, Uber, Zara) and enhancing your understanding of basic business principles.

The objective of this project is to enable you to conduct an independent comprehensive analysis of a large company (e.g., a Fortune 500 company). Select a company that you admire, a company that intrigues you, or a company that you would like to work for in the future. Hopefully, that company is publicly traded (such as one listed on the New York Stock Exchange), so that various types of information (financial and otherwise) are readily available. You should be able to obtain information from web searches and from your library. Library sources include *The International Directory of Company Histories* (Chicago: St. James Press), company annual reports, and reports from rating agencies such as Standard & Poor's, Moody's, and Fitch. By answering questions at the end of this section of each chapter, you should be able to understand your company better. Each chapter focuses on a specific topic, and the Case in Point questions will encourage you to analyze how that particular topic relates to your company. You will follow your company through every chapter of the book, and by the time you have completed Chapter 18, you will have learned almost everything you wanted to know about your chosen company! (Hint: Be sure to keep a bibliography of all the sources you use—both print and electronic. This bibliography will provide useful resources as you answer questions in later chapters. Also, your instructor may require a complete bibliography as part of this assignment.)

After reading this chapter, you should be prepared to answer some basic questions related to the type and nature of company that you have chosen to follow.

1. Determine when and where your company was established and its line of business. What are the major products/services provided by your Case in Point company? Does your company operate outside the United States as well? Where and why?
2. Is your company a private, public, or state-owned firm? How is business performance measured in your company? Is your company a for-profit or not-for-profit company?
3. What is the market structure of the industry in which your company operates? How did you come to that conclusion? Who are its major competitors? How has information technology impacted your company?
4. Who is the target audience of your company? How would you break down your company's consumers based on demographics and geographic location?

Starting Your Own Business—An Entrepreneurial Approach

Many students who take an introductory business course do so because they are considering starting their own business. Many instructors use a business planning project as a way to help students understand the interrelatedness of all the topics that are covered during the course. An essential first step to starting a new enterprise is developing a business plan. The business plan reflects the goals, strategies, and daily operations of the firm. Business plans are composed of several components. Following the organization of your text, these broad components could include the nature of contemporary business (Chapters 1–4), which covers issues related to the macro- and microeconomic environments in which your business will operate; management (Chapters 5–7), which delves into firm-level organizational issues; marketing (Chapters 8–10), which addresses the selling of goods and services; accounting (Chapters 11–12), which emphasizes the importance of bookkeeping in a firm; finance (Chapters 13–15), which identifies the various funding options available to firms; and operations and information technology (Chapters 16–18), which explores the role of information technology and supply chain management in facilitating day-to-day business operations.

The Portfolio Project at the end of every chapter lists questions on "Starting Your Own Business." These questions are intended to provide you with the opportunity to design your business plan. In addition, Chapter 4 is devoted to addressing issues related to small businesses and entrepreneurship. Furthermore, you can find web-based information on how to compose a business plan by connecting to the Small Business Administration's website (**www.sba.gov**) and clicking on "Starting Your Business." Before you begin this project, think about a business that you would like to start. Perhaps you have an idea for a completely new product or service; or maybe you have thought of a way to improve on an existing one. Whatever your business idea might be, questions in this section will help you think it through in detail. Perhaps you too could be an entrepreneur!

After reading this chapter, you should be able to address some basic issues related to the input and output of your firm, the firm's performance measures, and the impact of technology.

1. Describe the major inputs that will be used by your firm and the sources of these resources. Is the supply of inputs stable or is it volatile? What is your strategy for maintaining an uninterrupted supply chain for inputs at relatively stable prices?
2. How will you determine the market for your products or services? Will you analyze consumer diversity and demographics? What are the factors that will help you decide on an ideal location for your business?
3. Is yours a for-profit or not-for-profit business? Will your business be private or go public later? How do you plan to reinvest and grow your business? How will you determine success or failure in your business? How would you handle business failure, that is, what is your exit strategy?
4. What ethical standards have you set for your business? Are you diligent enough to keep your business sustainable in the long run?
5. Describe how you will use information technology to make your business efficient. What is the scope of competition from abroad?

TEST PREPPER

You've read the chapter, studied the key terms, and the exam is any day now. Think you are ready to ace it? Take this sample test to gauge your comprehension of chapter material. You can check your answers at the back of the book.

True/False Questions

Please indicate if the following statements are true or false:

_____ 1. Business is global in nature.

_____ 2. The goal of every business is to make a profit.

_____ 3. Profit is the difference between revenue and expenses.

_____ 4. When companies merge, the level of competition in the industry increases.

_____ 5. The economic system followed by the United States is called democratic socialism.

_____ 6. Transition economies are countries that are moving away from a system of free markets toward greater government control of productive assets.

_____ 7. Business ethics is not an issue as long as companies conduct business legally.

_____ 8. Selling products and services at a low price is more important than understanding consumer needs for business to be successful.

_____ 9. It does matter whether business uses nominal GNI or PPP-based GNI to determine market potential in countries.

_____ 10. The digital era is a fad and is unlikely to impact how business is conducted today or in the future.

Multiple-Choice Questions

Choose the best answer.

1. Peter Drucker defined business as organizations that create
   a. profit.
   b. goods and services.
   c. risk.
   d. value for the customer.
   e. revenue.
2. Which of the following statements is *not* true about the U.S. economy?
   a. The Industrial Revolution transformed the United States from an agrarian economy to an industrial giant.
   b. The factory system led to specialization of labor.
   c. The railroad era turned the United States into a unified market from coast to coast, leading to antitrust issues.
   d. The assembly-line era became incompatible with the formation of labor unions.
   e. The post–World War II era started the age of globalization.
3. The free-market system is based on all of the following *except*
   a. the theory of supply and demand.
   b. the notion of private property.
   c. the freedom to choose and enter into and exit out of industry.
   d. the assumption that the government knows best.
   e. the notion of property rights.
4. The key issues that affect the market structure include all of the following *except*
   a. the number of firms that operate in that industry.
   b. the ease of entry into that industry.
   c. the suppliers' control over prices in that industry.
   d. the similarity of products or services in that industry.
   e. the ownership of businesses in the industry.
5. Which of the following statements regarding the command economic system is *not* true?
   a. The government decides what, how much, and at what price goods and services are to be provided.
   b. The government's goal is to employ whoever is willing to work.
   c. The government allocates resources efficiently.
   d. The government tries to minimize income inequality.
   e. Consumers have little say in the system.
6. Which of the following is *not* a factor of production?
   a. Land and the natural resources beneath it
   b. Labor, including entrepreneurs
   c. Money and capital goods
   d. Government regulations
   e. Technology

7. Several countries would like business to maximize stakeholder wealth for all the following reasons *except*
   a. it takes into consideration the welfare of all business's constituents: customers, employees, suppliers, and society.
   b. it focuses more on long-term benefits than maximizing shareholder wealth does.
   c. it treats labor as more than a mere factor of production.
   d. it means that employees can be hired and fired easily.
   e. it is more responsible than maximizing shareholder wealth.
8. Business success depends heavily on understanding the consumer, whose consumption pattern depends on all of the following *except*
   a. how positive consumers feel about themselves and their jobs.
   b. population demographics.
   c. cultural diversity.
   d. inventory levels.
   e. psychographics.
9. PPP-based national income level is important for all of the following reasons *except*
   a. it is a good measure for comparing potential business opportunities across countries.
   b. it is a true measure of the size of an economy.
   c. it is a realistic measure of the wealth of the citizens of a country.
   d. it identifies the value of all goods and services produced by a country.
   e. it allows for comparison of GNI between countries.
10. The impact of the digital era on business is apparent from all of the following facts *except*
    a. companies are being transformed on a massive scale.
    b. customers are becoming smarter by using the Internet and social media.
    c. business is becoming more nimble.
    d. developing countries have been able to adopt the latest technology at lower cost.
    e. developing countries are being left behind.

APPENDIX

Purchasing Power Parity

Exhibit 1.9 lists the world's ten largest economies in terms of their nominal GNI levels (after converting local currency GNI into U.S. dollars) in 2021. The third data column of the table provides the midyear population in 2021, and the GNI per capita is computed in column four. This table clearly brings home the fact that both the size of an economy and its per capita income are important factors that businesses must consider. Because nominal official exchange rates (that you see in business newspapers daily) of foreign currencies with respect to the U.S. dollar do not always reflect differences in inflation rates between the country under consideration and the United States, a country's GNI needs to be converted into international dollars using **purchasing power parity (PPP)** conversion factors.

purchasing power parity (PPP) The purchasing power of an international dollar, which will have the same purchasing power in any country as the U.S. dollar has in the United States.

At the PPP rate, one international dollar will have the same purchasing power in any country as one U.S. dollar has in the United States. Hence, when foreign country GNI is converted to the PPP basis, it allows for realistic comparison of GNIs among countries. The PPP approach is a true measure of the economic well-being of the citizens of a country. Exhibit 1.10 lists the world's top ten countries in terms of their GNI based on PPP. When you carefully evaluate Exhibit 1.10, you will understand why businesspeople consider Brazil, China, India, Indonesia, and Russia to be important markets and competitors for the future. The greater the GNI per capita (PPP basis) in a country, the greater the purchasing power of the citizens in that country. The GNI (PPP basis) of the country as a whole is also important, since it gives businesses a feel for the country's potential market size.

Impact of IT on Globalization, Culture, Society, and Politics

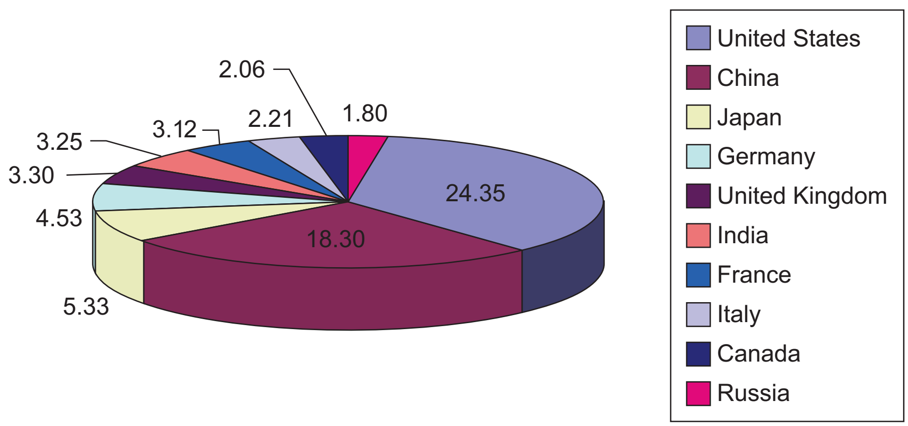
Although developing countries are widely thought to be losing out from ever-faster technological change, the Internet and related technologies are getting cheaper all the time, making timely information available instantaneously and globally. For example, IT Schools Africa, **itschoolsafrica.org**, a not-for-profit British organization, ships older PCs (as they get replaced by their sophisticated British owners) to African countries like Burkina Faso for reuse. Such programs of computer recycling enhance the computer skills of people in developing countries and improve their employment prospects. Everyone benefits. Countries with poor fixed IT infrastructure need not despair. Cell phones are popular everywhere, even in developing countries. In these countries, wireless IT has extra advantages, since fixed-line telephones are woefully inadequate and inefficiently run by state-owned monopolies. Some developing countries have created better communications infrastructures than rich countries, since they started late but adopted the latest wireless technology at lower cost. The Internet allows the adoption of outside technologies faster and helps the development of homegrown technologies that often use open-source (free, e.g., Linux) software. It also enables closer collaboration within and among countries. Governments need to remove obstacles and pursue transparent policies that encourage foreign investment and competition.

The IT revolution has barely started, yet its impact is being felt globally. Unlike changes brought about by such technological revolutions as electricity and the railroad, which took decades to spread around the globe, the IT revolution has been almost instantaneous. This reinforces the fact that IT and globalization are closely related. By reducing communications costs, IT has helped to globalize production and has encouraged a freer flow of goods and services, including capital, across national boundaries. In fact, IT acts as a catalyst in the globalization process by bringing down operating costs.

Internet and related social media technologies make many societies (especially political authorities in such societies as China, Central Asia, and the Middle East) uneasy. Political authorities in some societies, especially in nondemocratic or authoritative ones, wonder if uncensored information from countries abroad will corrupt local cultures and

EXHIBIT 1.9 World's Ten Largest Economies, U.S. Dollars 2021

Country	GNI (US$ billions)	% of World GNI	Population (millions)	GNI/Capita US$
United States	23,393	24.35	331.9	58,270
China	17,577	18.30	1,412.4	8,690
Japan	5,125	5.33	125.7	38,550
Germany	4,351	4.53	83.1	43,490
United Kingdom	3,170	3.30	67.3	40,530
India	3,124	3.25	1,393.4	1,820
France	3,002	3.12	67.5	37,970
Italy	2,125	2.21	59.1	31,020
Canada	1,976	2.06	38.2	42,870
Russia	1,733	1.80	143.4	12,085
World	96,067	100.00	7,836.6	12,259

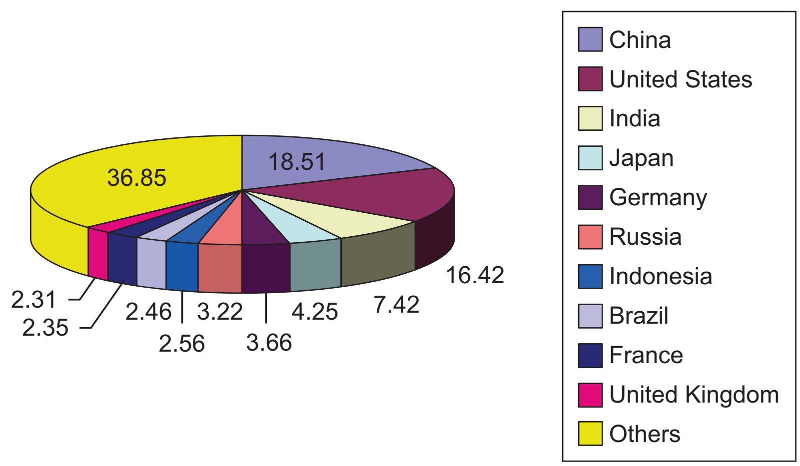


Source: World Bank, World Development Indicators, 2022, Table-1 World View.

bring about social and political instability. Advances in communications technology, for example, social media, could also shift the balance of power between ordinary people and their government and make dissent and tax avoidance safer. Internet-related communications help make societies and corporations less hierarchical because of greater access to everyone concerned. However, it is unlikely that Internet and related technologies will remain or even thrive completely free of government interference, even in industrialized countries. Most people like what modern technology has to offer. Developing countries are now making the same transition that the United States, Europe, and Japan made earlier, only they're making it faster and cheaper. In the transition period, this could cause political strain, especially in nondemocratic societies. Failure to adapt is bound to hurt some countries more than others. As current technologies get cheaper, they will spread faster the world over. While some governments will hold their countries back, the vast majority will move them forward.[14]

EXHIBIT 1.10 World's Ten Largest Economies 2021, PPP Basis (Constant 2017 International Dollars)

Country	PPI GNI (US$ billions)	% of World PPI GNI	Population (millions)	PPI GNI/Capita US$
China	22,835	18.51	1,412	16,168
United States	20,251	16.42	332	61,015
India	9,156	7.42	1,393	6,571
Japan	5,239	4.25	126	41,679
Germany	4,516	3.66	83	54,344
Russia	3,971	3.22	143	27,692
Indonesia	3,158	2.56	276	11,425
Brazil	3,029	2.46	214	14,161
France	2,901	2.35	68	42,978
United Kingdom	2,852	2.31	67	42,377
Others	45,460	36.85	3,722	12,215
World Total	123,368	100.00	7,837	15,743



Note: The PPP conversion factors used here are from the World Bank's World Development Indicators 2022 database, and are derived from the most recent round of price surveys conducted by the International Comparison Program, a joint project of the World Bank and the regional economic commission of the United Nations.

Source: World Bank, *World Development Indicators*, 2022 Database.