CHAPTER 1
What Is Business?

LEARNING OBJECTIVES

1. Identify the three major factors that are impacting business today and discuss the role of for-profit and not-for-profit organizations in an economy.
   - The three major factors impacting business today are globalization, information technology, and ethics.
   - Both for-profit and not-for-profit organizations attempt to provide value to consumers; however, not-for-profits' primary objective is to serve the public interest.
2. Summarize the evolution of business in the United States and explain the key issues that are impacting its outlook for the future.
   - Initially a free market, laissez-faire agrarian economy, the United States grew into an industrial giant during the nineteenth century Industrial Revolution following Britain.
   - The Railroad Era witnessed massive speculation and concentration of economic power that led to antitrust legislation.
   - Ford Motor Company ushered in the Assembly line era of manufacturing in 1913.
   - The end of WWII saw the birth of international organizations and cooperation.
   - International trade and investment liberalization laid the basis for our current era of globalization, information technology, and ethics.
3. Explain the fundamental features of the free enterprise, or capitalist, system that make it efficient and dynamic.
   - Private property rights
   - Pursuit of profits
   - Freedom to choose
   - Minimum government intervention in the marketplace
   - Market System: Interaction of supply and demand to determine equilibrium price

4. Discuss what is meant by *market structure,* and explain why most industries fall under the banner of monopolistic competition.
    - Market structure refers to the level of competition or number of producers or suppliers in a particular industry.
    - Pure competition—identical products with numerous suppliers
    - Monopolistic competition—differentiated products with several manufacturers
    - Oligopoly—similar products or services with few sellers
    - Monopoly—only one seller for a product or service
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.
    - Other forms of economic systems include:
    - Planned or command systems wherein the government determines national production and consumption based on national goals/plans
    - Mixed systems, which exhibit elements of both capitalist and planned economies
    - Transition economies that are in the process of moving from planned economic systems to a form of the free market system
    - The trend is toward progressive capitalism with private as well as state ownership of business.
6. Explain how the factors of production impact the supply of goods and services in an economy.
    - Factors of production are the inputs used by businesses in their production process: land and the natural resources below it, labor, capital, and technology that are used to produce the final output or product. The greater the quantity and quality of inputs in an economy, the larger the amount of goods and services produced in that 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.
    - Businesses performance in a free market system is measured in terms of meeting consumer needs, maximizing profits and shareholder wealth.
    - In socialist economies (as well as in progressive capitalist systems) firms try to maximize stakeholder (investors, customers, suppliers, employees and society) wealth and minimize income inequity.
    - Not-for-profit organizations differ in that their primary objective is to serve society.
8. Explain the important role consumers play in determining corporate performance and show how businesses try to identify consumer needs.
    - Businesses that do not meet consumer needs or provide value will cease to exist in the long run.
    - Significant monies are spent to research and analyze consumers (using algorithms) as well as their perceptions and needs.

9. Discuss why and how national output is measured.
   - Gross national product (GNP) is a measure of a country's output and it reflects the value of all final goods and services produced by a country's factors of production and sold at market prices over a period of time, usually a year.
   - GNP is an indicator of a country's economic wellbeing, including its living standard, health status, and educational attainment.
10. Evaluate the impact of the digital revolution on global businesses, governments, and societies.
   - The innovations in information technology produced by the digital era are leading to:
   - Massive transformation of companies especially in the information technology sector that is leading to monopolistic structures.
   - Smarter, more demanding customers and consumers.
   - Need for nimble, knowledgeable, competitive and transparent operations.
   - Increased call for antitrust policies to enhance competition, transparency, improved governance to advance economic and social well-being for all.

CHAPTER OUTLINE

I. Introduction

II. Types of Economic Systems and their Impact on Business

III. Production of Goods and Services

IV. Measuring Business Performance

V. Demand for Goods and Services

VI. The Digital Era

CHAPTER RECAP

I. INTRODUCTION
The three major factors affecting business today are globalization, information technology, and ethics.

A. Defining Business and Profit
   1. Peter Drucker defined **businesses** as those organizations that create value for customers.
   2. **Profit** is the difference between revenue (income or sales) and expenditures (cost of goods or services sold).
   3. Two types of businesses

a) **For-Profit**
   (1) Businesses that sell goods (gasoline, burgers, cars, computers) and services (haircutting, banking, legal advice, medical treatment)
b) **Not-For-Profit**
   (1) Organizations that provide goods and services without the goal of making a profit (the Salvation Army, Goodwill Industries, educational institutions, and the like)

B. The Evolution of Business in the United States
1. Early settlers from Europe found an attractive business climate in America due to:
   a) More permissive government policies.
   b) Abundance of land.
   c) Diverse natural resources.
   d) Constant inflow of labor (migrants) and capital.
2. The Industrial Revolution (1815 to 1875) transformed the United States from an agrarian economy to an industrial giant. Driven by:
   a) Continental-sized land mass
   b) Large mineral deposits
   c) Scarce but growing labor force
   d) Individualist philosophy
   e) High returns on investment
3. **Factory system—**Mass production of standardized items beneath one roof, less expensively. Driven by:
   a) Raw materials and machinery purchased in bulk
   b) Mass production, which resulted in economies of scale
   c) Growing demand for mass produced goods, which improved profits but caused labor shortages
      (1) Led to **specialization of labor—**Workers grouped on the basis of their skills and specific tasks
4. The **Railroad Era** and **laissez-faire** government policies led to market domination.
   a) From 1875 to 1913, the U.S. share of world manufacturing grew from 23 percent to 36 percent.
   b) Key contributing factors to U.S. economic growth
      (1) A steady growth in population through immigration
      (2) A high rate of business investment
   c) **Market domination** through acquiring competitors or colluding with them to control prices and prevent competitors from entering the market:
      (1) Led to **antitrust policies** designed to break up monopolies and to control abuses by business.
5. The **Assembly Line Era**
   a) Pioneered by the Ford Motor Company in 1913
      (1) A conveyor or moveable device brought an incomplete car to workers thereby reducing the time and effort to produce a specific task in assembling the complete car
   b) Assembly lines increased productivity but caused worker dissatisfaction.
      (1) Resulted in rise of unions and government protection of workers' rights

6. The Post-World War II period: The **Globalization Era**
    a) Several new international financial institutions were set up to facilitate international trade and investment flows to spur economic growth.
        (1) The International Monetary Fund (IMF) facilitated and supported stable exchange rates and the flow of capital to make it easier for countries to invest in and trade with each other.
        (2) The World Bank provided financial and technical assistance originally to rebuild Europe.
    b) The General Agreement on Tariffs and Trade (GATT), renamed the World Trade Organization (WTO) in 1995, was established in 1947 to set rules of conduct for international trade.
        (1) Each trade liberalization step has led to increased globalization of business along with the worldwide economic and social advances that we are witnessing today.

C. The New Society of Knowledge Workers
1. Society is moving from manual workers to knowledge workers.
    a) In 1913, farm products accounted for 70 percent of world trade. Today their share is at most 17 percent.
    b) Manufacturing employment in the U.S. has fallen from 35 percent of the workforce in the 1950s to less than half of that now.
2. **Knowledge workers** are people whose jobs require formal and advanced schooling.
3. The main characteristics of the knowledge workforce:
    a) Borderless
    b) Upwardly mobile
    c) Being offered the potential for success
4. The **new economy:** An economy largely driven by developments in information technology and the Internet and characterized by:
    a) Borderless global competition
    b) Heavy reliance on knowledge workers
    c) Growing social and political strength of knowledge technologists—Computer technicians, software designers, big data analysts, artificial intelligence designers, clinical lab analysts, manufacturing technologists and paralegals

II. TYPES OF ECONOMIC SYSTEMS AND THEIR IMPACT ON BUSINESS

Countries have adopted different approaches to allocate their scarce **economic resources** (land, labor, capital, and technology). A country's economic system depends on the following factors:

- Private versus government ownership of the factors of production
- Method of resource allocation
- Transparency of economic policies
- Availability of functioning institutions

A. The Free Enterprise or Capitalist System
1. **Capitalism—**The economic system that is based on private property rights, the free market system, the pursuit of self-interest and profit, the freedom to choose, and the ability to borrow money.

2. **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.
    a) Countries with relative free market systems include the United States and most European countries as well as other industrialized countries such as Japan, South Korea, Taiwan, Singapore, and Hong Kong.
3. Demand, Supply, and Price
    a) **Law of demand—**consumers will buy more when prices fall and less when prices increase.
    b) **Demand curve—**The curve that shows the relationship between the quantity demanded and the price of a product or service for a particular customer or group.
    c) **Price inelastic demand—**Significant increases in the price of a product or service will have little effect on the quantity demanded.
        (1) Example: A significant increase in the price of cigarettes will have little effect on the quantity of cigarettes demanded.
    d) **Price elastic demand—**A small change in the price will have a significant impact on the quantity demanded of a product or service.
        (1) Example: A relatively small change in the price of DVDs will have a significant impact on the quantity demanded.
    e) **Law of supply—**Producers will be willing to sell more when prices rise and less when prices fall.
    f) **Price inelastic supply—**A large change in price will have little impact on the quantity of a good or service supplied.
        (1) Electricity has a price inelastic supply.
    g) **Price elastic supply—**A small change in price will bring about significant increases in the quantity of a product or service supplied.
        (1) Beef has a price elastic supply.
    h) **Market clearing** or **equilibrium—**The price at which supply will equal demand
        (1) **Shortage—**Demand exceeds supply
        (2) **Surplus—**When market supply exceeds market demand
4. Private Property and Property Rights
    a) **Capitalism** is a system based on private property (land as well as personal property, e.g. house, car, furniture, books, etc.)
    b) **Property rights—**A person's freedom to buy, own, use, and sell their property
        (1) Countries that restrict property rights (e.g. communist countries) restrict innovation and business since people do not have the freedom of choice to do what they want and make profit.
5. Degrees of Competition
    a) Firms are founded to satisfy consumer unfulfilled needs and in so doing to make a profit before their product or service becomes obsolete.
    b) **Product life cycle—**The different stages that a product goes through before it fades away: introduction, growth, maturity and decline.

c) **Market structure** is the level of competition within an industry and is defined as the organization of an industry determined by the level of competition within the industry.

d) **Pure competition—**The industry market structure where there are a large number of suppliers that produce essentially identical products, which are sold at a price determined by the market.
   (1) Example: Agricultural products (beef, chickens, milk, etc.)

e) **Monopoly—**The industry market structure where there is essentially a single supplier of goods or services, which has the power to set prices.
   (1) Example: Electric utility company

f) **Imperfect competition—**The industry market structure where the industry's output of goods or services are supplied by a relatively small number of firms and price is largely determined by market forces.
   (1) **Firm concentration ratios—**The percentage of total industry output that can be accounted for by the four largest firms.
      (a) Example: The auto industry in the United States

g) **Barriers to competition** (entry)—Legal restrictions that reduce competition
   (1) **Patents—**Exclusive rights provided by governments to companies or individuals to produce goods
      (a) Examples: pharmaceutical products or software for operating systems
   (2) **Licensing—**When governments select certain investors to operate a particular type of business or when companies permit other firms to manufacture identical products using their proprietary technology.
      (a) Examples: cement, manufacturing, steel production, pharmaceuticals
   (3) **Tariffs—**Taxes on imports that raise the price of imports to consumers and protect domestic producers. A detrimental practice in several countries.

h) **Oligopoly—**The industry market structure where a few producers of almost identical products or services cater to the needs of the whole market
   (1) Examples: Smart phones, Wi-Fi service, Cement, steel, coal producers, airlines, etc.
   (2) Since the products or services are so similar when an oligopolist lowers price, consumers will immediately switch to the low cost seller.

i) **Monopolistic Competition—**The key characteristic of monopolistic competition is product differentiation, a strategy that firms employ to make their product seem different from those of their competitors.
   (1) Companies use a variety of marketing approaches (i.e., branding, advertising) to promote their products or services as unique.
      (a) Examples: Perfume, soda pop, toothpaste, detergents, jeans, sneakers
   (2) Most industries fall in the category of monopolistic competition. See Exhibit 1.5 in the text.

B. The **Command** or **Planned Economic System**
   1. This is an economic system in which the ownership and control of the factors of production are totally in government hands. In this system the government's objectives are:
      a) Utilize as much domestic resources as possible.
      b) Employ whoever is willing to work in order to minimize unemployment.
      c) Minimize income inequality among workers.
      d) Provide limited choice of where to work and the type of work.
   2. Examples of countries with command or planned economic systems include the former Soviet bloc countries, Cuba, and North Korea.
   3. Because of the lack of market mechanism (i.e., no profit incentive), quality consumer goods are rare and quantities are in short supply. The concepts of competition and private property do not exist.
      a) These elements result in the production of goods that consumers do not want and a scarcity of other goods that consumers want.
   4. **State enterprises—**Government-owned firms that produce goods and services in a command economy

C. The **Mixed Economic System**
   1. This is an economic system that exhibits elements of both the capitalist and the command economic system.
      a) Not all services can be provided by a purely capitalistic system (defense, social welfare, etc.); therefore, the government provides them.
      b) Most countries utilize mixed economic systems although countries with mixed economies are not all alike. For example, in emerging economies such as China and India, several major companies in the manufacturing and service sectors are owned by the government.
   2. The larger the role state enterprises play in an economy, the greater the prospect of inefficiency due to overstaffing, lack of employee motivation, and underperformance of workers.
   3. The current trend in mixed economies (like France and India) is to move to **privatization—**the process of selling state enterprises to private entrepreneurs.
      a) Governments can then focus their attention on providing services that cannot generally be provided by private firms (i.e., defense and social welfare).

D. The **Transition Economies**
   1. Economic transition is the move from a command and socialist economic systems to a progressive capitalist system in the direction of competitive, market oriented economics. This transition is aimed at ending the inefficiencies of central planning.
      a) China, India, and the former Soviet bloc are examples of countries with transition economies.
      b) China in 1978 initiated market reforms, i.e., profit incentives to rural enterprises and private businesses, liberalized foreign trade and investment regulations, relaxed state control over some prices, invested in industrial infrastructure and the education of its workforce.

2. The experience of countries with transition economies is that privatized enterprises invariably outperform state run companies.
3. Research shows that firms that start from scratch with new management perform best, followed by newly privatized firms run by outsiders (either local or foreign). Privatized firms managed by insiders are found to be least productive/efficient but still better than state run enterprises.

III. PRODUCTION OF GOODS AND SERVICES
- A. In free market countries like the U.S., economic size is measured in terms of its **outputs—**a wide array of useful goods or services that are either consumed or used for further production in business.
- B. Every output requires factors of production called **inputs**
  1. **Land—**Consists of ground (used for agriculture, under factories, airports, roads) and natural resources, which can be nonrenewable resources (coal, crude oil, and iron ore) and renewable resources (trees used in the production of lumber and paper).
  2. **Labor—**Human time spent in productive activities
     - a) Running a farm
     - b) Working in a factory
     - c) Teaching
     - d) Conducting research
     - e) Running a business
     - f) **Entrepreneurs—**People with initiative who seize opportunities for profit
  3. **Capital**
     - a) Money (financial capital)—To buy raw materials, pay salaries, buy services, etc.
     - b) Capital Goods (physical capital)—Machinery, equipment, factories, trucks, computers, software, etc. that can be used as inputs for further production of goods and services.
  4. **Technology—**To improve and make production more efficient
     - a) Information technology
     - b) Reengineering
     - c) Process technology

IV. MEASURING BUSINESS PERFORMANCE
- A. Maximizing Profit and Shareholder Wealth
  1. All firms need to make a profit to remain in business.
     - a) Profit is the difference between revenue and the costs of goods or services sold. See Exhibit 1.6 in the text for the relationship between revenue, expenses, and profit.
       - (1) Revenue is the sum of the quantities of all goods and services sold times their price.
  2. Large companies borrow money from banks and sell stock to investors (shareholders) to raise money to run the business. While companies cannot guarantee a return, their goal is to maximize shareholder wealth by paying dividends to their shareholders and increasing their stock price over time.
- B. Maximizing Stakeholder Wealth

1. In the U.S., employees are generally regarded as a factor of production. Thus when the economy is down or a company is not doing well, the U.S. norm is to lay off workers in order to reduce costs and maximize shareholder wealth.
2. The Europeans and Japanese generally believe that laying off workers is too ruthless. They believe in a broader corporate objective of maximizing stakeholder wealth rather than shareholder wealth.
3. Transition economies as well as the Europeans and Japanese support the concept of a stakeholder company, which is a business that takes into consideration the interests of all its partners, including its customers, management, employees, suppliers, and society.
    a) In stakeholder companies, employees are considered more than a factor of production, and they cannot be hired or fired easily.
    b) 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 as compared to 400:1 in the United States.

C. Minimizing Unemployment and Income Inequalities
1. In several developing countries (Africa, Asia, the former Soviet bloc, and Latin America) the primary objective of government owned state enterprises is to keep people employed. As a result, state enterprises are generally overstaffed and the employees underpaid.
    a) This creates a vicious cycle. Because the employees are poorly paid they don’t work hard. Since they don’t work hard, productivity is low and they are entitled only to low wages.
2. A related objective of state enterprises is to minimize income inequalities in a country. It is argued that in a free enterprise system the rich get richer and the poor get poorer. Politicians can use state enterprises where most employees are paid almost the same as a tool to bridge the gap between the rich and the poor. The drawback of this approach is that it focuses on income distribution to the detriment of profit generation and economic growth.

D. Not-for-Profit Organizations
1. Not-for-profit organizations play an extremely important role in an economy. They provide goods and services that would not be otherwise available to a society. Examples:
    a) Public schools
    b) State universities
    c) Boy/Girl Scouts
    d) United Way
    e) UNICEF
    f) Doctors without Borders

V. DEMAND FOR GOODS AND SERVICES

The role of the consumer is paramount for business growth and profitability. Approximately 70 percent of the U.S. economy is based on private consumption. When the U.S. consumer cuts her/his spending, consumption shrinks and inventory (unsold goods) builds up. When inventory buildup reaches a high enough level, businesses cut production, layoff workers, and the economy contracts.

A. Measuring Consumer Confidence
  1. When consumers feel good about their job, job security, salaries, and their general home environment they are more likely to spend thereby stimulating economic growth.
    a) Steady economic growth indicates businesses are doing well and are generating profits.
      (1) When businesses do well they employ more people and pay more corporate taxes.
        (a) This results in higher employment which in turn generates more income taxes and also reduces unemployment benefits and social problems.
  2. A closely watched measure of consumer confidence is the **Consumer Confidence Index** (samples 5,000 U.S. households, monthly by the Conference Board).
    a) When the index rises it indicates consumers are more confident and implies that consumers may continue spending, and business revenues and earnings will be strong
    b) When the index drops it indicates to firms that they should not be optimistic about the immediate business environment and may want to curb spending/expansion plans.
  3. The Expectations Index (also put out by the Conference Board) measures the consumer outlook for the short term.
    a) A rise in this index indicates that overall, consumers are optimistic about the short-term outlook for the U.S. economy.

B. The Consumer Knows Best
  1. Given the importance of the consumer to the survival of a business, key questions are:
    a) Who is the consumer?
    b) Are all consumers alike?
    c) Do culture, income, demographics, national boundaries, etc., impact a consumer's purchasing habits?
  2. The test of business success is in the marketplace, and in the marketplace the consumer rules!

C. Consumer Demographics and Psychographics
  1. The population of the U.S. consumer is quite diverse and of great interest to businesses as they try to determine what to produce for whom.
    a) The U.S. population was 309 million in 2012 and had the following demographics.
      (1) 51% is female
      (2) 13% is African American
      (3) 16% is Hispanic
      (4) Approximately 7% is in the 15–19 age group
      (5) 13.4% is in the 25–34 age group
      (6) 13% is in the 35–44 age group
      (7) 14.2% is in the 45–54 age group
      (8) 26% are over 55 years old

2. While consumers are not all alike and have different tastes and needs for goods and services, a population segment can be identified whose members more or less have similar consumption habits. These are called target markets and the process of marketing to them is called market segmentation.
   a) **Market segmentation** is the breakdown of target consumers into categories on the basis of age, gender, education, ethnic background, or other criterion to determine the products or services that could be made to suit the segments' specific needs.
      (1) This breakdown can be made by demographics (i.e., age, gender, occupation, location, ethnic background, etc.) and/or by psychographics (an analysis of the consumer by identifying likes, dislikes and preferences).

D. Cultural Diversity
   1. **Culture—**The behavior patterns, beliefs, and institutions that underpin all human activities, explain much of our behavior, create awareness for learning and vary by social group.
   2. Cultural differences exist not only between countries but within them. The U.S. is an amalgamation of people with different ethnic backgrounds, religion, and social class all living in one economic environment.
   3. With increased globalization, consumer tastes and behavior will change across cultures at an increased pace. However, companies must still accept and adapt to foreign cultures if they are to be successful.
      a) McDonald's, for example, has tried to adapt its menus to meet the needs of different cultures such as the McArabia sandwich that it serves in Saudi Arabia.
      b) Coca-Cola has stressed the importance of promoting local brands such as Limca (a lemonade drink) in India rather than trying to change tastes to its Coca-Cola product.
      c) DaimlerChrysler manufactures its Mercedes M-class SUVs in Alabama for sales almost exclusively in the U.S.
   4. The success of companies like Samsung, Sony, Toyota, VW, Microsoft, IBM, GE, Lockheed Martin, Merck, Johnson & Johnson, Procter & Gamble, and so on is due to their willingness to adapt goods and services to meet local demand.

E. Measuring Gross National Product, Gross National Income, and Gross Domestic Product
   1. Another important factor that impacts consumer behavior and business performance is income level, which when measured on a national basis is a country's **gross national product (GNP).**
      a) GNP is the value of all final goods and services produced in an economy and measured at current prices over a given time period, usually a year.
      b) The expenditures (income earned) tied to the employment of each factor**—** land, labor, capital, and technology is called **gross national income (GNI)** and is equal to GNP.
         (1) GNI equals GDP because every dollar used to purchase goods or services automatically ends up as somebody's income.

c) GNP is divided among four main uses for which a country's output of goods and services is purchased.
(1) Consumption (the purchases of private domestic residents)
(2) Investment (the spending by private firms to build plant and equipment for future production)
(3) Government expenditure (the amount spent by the government)
(4) Net exports (the amount of goods and services sold overseas less the amount of goods and services bought from abroad)
d) **Gross Domestic Product (GDP)** is the total dollar value of all final goods and services produced each year within a country's borders.
e) Nominal GNI, GNP, or GDP is measured in current prices. Real GNI, GNP, or GDP is measured on an inflation-adjusted basis. See Exhibit 1.8 in the text.

F. Business Cycles
1. **Business cycles** are the up and downswings in real GNI, GNP, or GDP levels over time.
a) During the expansion phase, output, employment, and investment all tend to rise indicating a period of prosperity. The contraction phase is when output, employment, investment, and inflation begin to fall reflecting a period of hard times.
b) Economists study business cycles in order to identify turning points so that appropriate policies can be implemented to smooth out the cycles.

VI. THE DIGITAL ERA

The digital era is a period of transformation wherein people are making the Internet and related technologies a part of their everyday lives.

A. E-Business
1. The Internet is creating new business models that are radically changing how business is done. The impact of the Internet on our lives depends on the answer to the following questions:
a) How radically will the Internet change day-to-day life?
b) How much does it require businesses to reorganize their production processes to become more productive and efficient?
c) What will the impact of this new technology be on business across the whole economy?
2. Key business trends that are emerging in the digital era
a) Established companies are undergoing radical changes in strategy, structure, and process.
(1) For example, most auto dealers in the U.S. quote car prices upfront over the Internet.
b) Customers are becoming smarter and more demanding.
(1) Customers can now determine product availability, feature comparisons, prices, and suppliers of products like computers, autos and TVs over the Internet.
c) Business is becoming more nimble.
(1) Samsung uses the Internet to dominate the smartphone market by allowing customers to gather information, order products, pay their bill,

track the delivery of their purchase, and obtain service once the product is delivered.

d) Knowledge is the key asset.
   (1) Because of its high number of college graduates, India provides an abundant supply of talented IT professionals who work in e-business.

e) Transparency and openness are crucial for success in the digital era.
   (1) Companies are discovering a competitive advantage in making information available to their customers and networked partners. Airlines, for example, now disclose discounted fares to travelers, which previously were only shared with travel agents.

3. Despite the collapse of many IT and dotcom firms in 2000, e-business will lead to higher productivity for businesses over time and result in lower prices and higher living standards for consumers.

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

1. IT and globalization are closely related. IT has helped to globalize production and has encouraged a freer flow of goods, services, and capital across national boundaries. IT acts as a catalyst in the globalization process by bringing down operating costs.
2. IT affects society and culture by providing communications to relatively closed countries and bringing information and new ideas to people who otherwise would not have access.
3. The Internet makes political authorities in countries such as China, Central Asia, and the Middle East uneasy. While some governments will restrict IT and the Internet because they fear the information they bring will corrupt local cultures, over time most of these countries will succumb to the pressure of the people.

KEY TERMS AND DEFINITIONS

Businesses Those organizations that try to create value for the customer

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

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

Risk The probability that the business will fail

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

Specialization of labor Grouping employees to work on assigned tasks on the basis of their specific skills and factory demand

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

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

Globalization The process of integrating the market for goods and services worldwide.

New economy An economy largely driven by developments in information technology and the internet.

Knowledge workers Employees whose jobs require formal and advanced schooling

Economic resources Land, labor, capital, and technology that are scarce

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.

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.

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

Demand curve The curve that shows the relationship between the quantity demanded and the price of a product or service for a particular customer, group of consumers, or even a whole country. (it 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

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. (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.

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.)

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 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.

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

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

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 of time, 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

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

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

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

Privatization The process of selling state enterprises to private entrepreneurs.

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

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.

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

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

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

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

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.

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

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

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

Inventory Unsold goods in stock

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.

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

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.

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

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 period, 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.

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

Nominal GNI, GNP, or GDP Economic output measured in current prices

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

Business cycles The up- and downswings in real GNI, GNP, or GDP levels over time.

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.

B2C Business-to-consumer electronic commerce

B2B Business-to-business electronic commerce

REVIEW QUESTIONS

True-False Questions

1. T F According to Peter Drucker, businesses are organizations that make a profit.

2. T F The factory system is efficient in mass-producing large quantities of standardized goods.

3. T F Capital, one of the factors of production, consists of both money and durable goods.

4. T F Nominal GNP measures the gross national product in current dollars, while real GNP uses inflation-adjusted measures.

5. T F The trend toward increased use of the Internet and e-commerce primarily favors companies from wealthy, developed nations.

Multiple Choice Questions

1. Walmart is headquartered in the United States, but about $1.5 billion of its profits are made from stores located outside the U.S. The $1.5 billion income from foreign Walmart Stores would be included in
   a. both Gross Domestic Product (GDP) and Gross National Product (GNP).
   b. GDP only.
   c. GNP only.
   d. neither GDP nor GNP.
   e. GDP as a positive value and GNP as a negative value.

2. Which of the following would *not* be included in the U.S. GDP?
   a. The value of professional services provided in the U.S. by a citizen of Canada living in the U.S.
   b. The value of a car made in the U.S. by a Japanese-owned factory.
   c. The value of a television set made and sold in the U.S. to U.S. residents who are not citizens.
   d. The value of housework done by U.S. citizens for no pay in a U.S. household.
   e. The value of a car wash performed in a U.S. car wash facility.

3. In considering which countries offer the most favorable future opportunities for business, the most important factor for a company to consider is the country's
   a. annual nominal gross national income (GNI).
   b. annual real GNI.
   c. annual nominal GNI per capita.
   d. population growth.
   e. annual real GNI per capita.

4. When in the business cycle would inflation tend to be increasing the fastest?
   a. On the rise of an upswing
   b. At the peak of an upswing
   c. During the fall off after an upswing
   d. At the bottom of the cycle
   e. During the contraction phase

5. As compared to previous technological revolutions such as the internal combustion engine or electricity, the Internet technological revolution
   a. is occurring much more rapidly.
   b. is making undemocratic foreign leaders happy.
   c. is slower to reach remote areas.
   d. is more favorable to more developed nations.
   e. has more government interference.

Fill in the Blank

1. The law of demand states that consumers will buy less of a product or service when its price ________.

2. Ironically, centrally-planned economies are more likely to experience acute shortages and ___________ of goods than free market economies.

3. Risk is associated with reward. Business people take a risk that their business might fail in order to get a reward, which is ____________________.

4. Recently Microsoft Corporation was prosecuted by the U.S. and several state governments for being too large and powerful, dominating the computer software market, and engaging in anticompetitive tactics. Microsoft was found guilty of ____________ laws.

5. India sold its government-owned aluminum mining company, Bharat Aluminum, to private investors in 2001. This is an example of _____________________.

Matching Questions

I. Match the identity

1. The United Way
2. A laissez-faire system of government
3. A capitalistic economy
4. In a market system

A. is primarily controlled by consumers and producers.
B. prices tend to move toward the equilibrium
C. is a not-for-profit organization.
D. allows businesses to do what they please.

II. Match market structure with the type of industry

1. Oligopoly
2. Imperfect competition
3. Monopoly
4. Pure competition

A. Public Utility
B. Airline Industry
C. Dairy Farming
D. Athletic Shoes

III. Match factors of production

1. Knowledge workers
2. Weather conditions
3. Entrepreneurs
4. Land and labor

A. are individuals who are good at exploiting business opportunities

B. are increasing in today's global economy
C. are called primary factors of production
D. are *not* a factor of production

CHAPTER DISCUSSION QUESTIONS

4. **What is profit? How might you try to improve profits if your company is not doing as well as you think it should?**

   Profit is the difference between revenue (sales) and cost (of all inputs). Profits could be improved by either increasing sales revenue, cutting cost, or doing both at the same time. To increase sales, one could advertise (TV, newspapers, billboards, coupons, etc.) and enhance quality of the product or service. One could also reduce the price by eliminating waste. Or less expensive methods of distribution could be explored. Cost could be reduced by increasing efficiency of operation and outsourcing inputs at competitive prices.

5. **What is globalization, and what are the origins and effects of globalization on U.S. business?**

   Globalization is the process of integrating the markets for goods and services worldwide. The more recent origins of globalization can be traced to institutions like the GATT/WTO, the World Bank, and the IMF that have played an instrumental role in reducing trade barriers and maintaining stable exchange rates across countries to facilitate and increase trade among member countries. More specifically, the GATT/WTO has lowered tariffs and eliminated most quotas enabling member countries to increase trade in goods and services and also increase investment in countries contributing to rising global income growth. American businesses have benefited significantly by expanding their overseas sales and investment opportunities, and they dominate the global scene. Many large U.S. firms derive the bulk of their profits from their overseas operations.

3. **Why is a "purely competitive" market structure best for consumers and society alike? Is it good for business as well?**

   In a purely competitive market structure there will be numerous suppliers of similar products and/or serives. Under such a situation, no one supplier will be able to control market price or raise prices. For if he or she does raise prices, consumers will purchase goods from competitors and the former will be out of business. Consumers are always better off under a system of pure competition. Some businesses may not like pure competion since they are at the mercy of the consumer and businesses cannot dictate prices. Pure competition brings much needed discipline in the marketplace and levels the playing field for all firms in the market.

4. **Compare shareholder wealth maximization with stakeholder wealth maximization. Which approach do you prefer, and why?**

   Maximizing shareholder wealth is pretty straightforward. Here, firms try to maximize corporate profits so that shareholders will witness rising stock prices and provision of steady dividends. This is relatively easy to quantify. Stakeholder wealth maximization includes maximizing the welfare of not only the shareholder but also employees, suppliers, and society. The belief is that unless the welfare of all these constituents is taken into consideration, the firm may not be successful in the long run. While this is largely true and is followed by many companies in

Europe and Asia, the efficiency versus equity issue will need to be bought by the public. All things said, even companies that try to maximize shareholder wealth try to get involved in corporate social responsibility and employee benefits programs.

5. **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?**

   The four major componets of GDP are private consumption, investment, government expenditure and net exports. Private consumption drives the U.S. economy since approximately 70 percent of U.S. GDP is this single component. So, if private consumption declines in the U.S. it will have a major impact on GDP growth and the economy. The American consumer therefore plays a crucial role in the economic well-being of the country. Businesses therefore pay close attention to the Consumer Confidence Index, which measures how confident Americans are about their outlook for the economy and hence their spending habits. When the index rises, it indicates that consumers will be willing to spend freely and businesses will be encouraged about potential sales and will increase investment.

ANSWERS TO REVIEW QUESTIONS

True-False Questions

1. Ans:False; L.O.: 1; Ref: Page 5
2. Ans:True; L.O.: 2; Ref: Page 6
3. Ans:True; L.O.: 6; Ref: Page 18
4. Ans:True; L.O.: 9; Ref: Page 28
5. Ans:False; L.O.: 10; Ref: Page 29

Multiple Choice Questions

1. Ans: C; L.O.: 9; Ref: Page 27
2. Ans: D; L.O.: 9; Ref: Page 28
3. Ans: C; L.O.: 9; Ref: Page 28
4. Ans: A; L.O.: 9; Ref: Page 29
5. Ans: A; L.O.: 10; Ref: Page 30

Fill in the Blank

1. Ans:rises; L.O.: 3; Ref: Page 10
2. Ans:surpluses; L.O.: 5; Ref: Page 16
3. Ans:profit; L.O.: 1; Ref: Page 5
4. Ans:antitrust; L.O.:2; Ref: Page 7
5. Ans:privatization; L.O.: 5; Ref: Page 17

Matching Questions

I. 1(C), 2(D), 3(A), 4(B)

II. 1(B), 2(D), 3(A), 4(C)

III. 1(B), 2(D), 3(A), 4(C)