Chapter 1: The U.S. Business Environment

Chapter Overview

Many students come to an introduction to business class not quite sure what it's all about. The course has something for everyone, from those who have been in the business world a while to those just getting started. As the book unfolds, you'll develop an understanding of the foundations of business and will be able to apply what you already know (or what you are starting to learn) about business to many aspects of the course.

This first chapter dives right into the world of business, explaining what business is, what its main goals and functions are, and how the external environments of business affect the success and failure of any organization. The chapter also:

- Defines the nature of U.S. business, describes the external environments of business, and discusses how these environments affect the success or failure of organizations.
- Describes global economic systems according to the means by which they control the factors of production.
- Shows how markets, demand, and supply affect resource distribution in the United States.
- Discusses the elements of private enterprise and the degrees of competition in the U.S. economic system.
- Explains the importance of the economic environment to business and identifies the factors used to evaluate the performance of an economic system.

Learning Objectives

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

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

3. Show how markets, demand, and supply affect resource distribution in the United States, identify the elements of private enterprise, and explain the various degrees of competition in the U.S. economic system.

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

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LIST OF IN-CLASS ACTIVITIES: INSTRUCTOR'S CHOICE

Activity	Description	Time Limit
1. Ice-Breaker: What Do You Know About Business?	Students assess their level of knowledge about business and set their own learning goals for the class.	20 min.
2. Small Group Discussion: Scanning the Environment	Students consider how parts of the external environment affect businesses and industries.	25 min.
3. Up for Debate: Comparing Economic Systems	Teams of students discuss types of economic systems.	30 min.

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CHAPTER OUTLINE

Learning Objective 1-1:

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

Business and Profit

A **business** is an organization that provides goods and services to earn profits. **Profits** are the difference between a business's revenues and expenses.

1. **Consumer Choice and Demand:** In a capitalistic system like that of the United States, consumers have freedom of choice. In turn, businesses must take into account consumer demand as shown through wants and needs in their pursuit of profits.

2. **Opportunity and Enterprise:** Opportunity involves goods or services that consumers need or want, especially if no one else is supplying them or if existing businesses are doing so inefficiently or incompletely.

3. **The Benefits of Business:** Businesses produce most of the goods and services consumed, employ most working people, create new innovations, and provide opportunities for new businesses to serve as suppliers. Further, businesses contribute to the quality of life and the standard of living in a society. Businesses provide incomes, taxes to support government, support to charities and community leadership.

The External Environments of Business

The **external environment** consists of everything outside an organization's boundaries that might affect it. Managers must understand their environment to understand how to operate and compete within it. Businesses can also influence their environments. Six major dimensions of the external environment are:

1. **Domestic Business Environment.** The domestic business environment refers to the environment in which a firm conducts its operations and derives its revenues. It includes customers, suppliers, and competitors.

2. **Global Business Environment.** The global business environment refers to the international forces that affect a business; various factors including international trade agreements, international economic conditions, and political unrest affect the global environment at both the general and immediate levels. International market opportunities, suppliers, cultures, competitors, and currency values can impact any business.

3. **Technological Environment.** The technological environment generally includes all the ways by which firms create value for their constituents; technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems used to perform business activities.

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4. **Political-Legal Environment.** The political-legal environment reflects the relationship between business and government, usually in the form of government regulation of business.

5. **Sociocultural Environment.** The sociocultural environment includes the customs, mores, values, and demographic characteristics of the society in which an organization functions.

6. **Economic Environment.** The economic environment refers to relevant conditions that exist in the economic system in which a company operates.

Use In-Class Activity 1: **Ice-Breaker: What Do You Know About Business?**
Time Limit: 20 minutes

*Use In-Class Activity 2***: Small Group Discussion: Scanning the Environment**
Time Limit: 25 minutes

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Learning Objective 1-2:

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

Economic System

An **economic system** is a nation's system for allocating its resources among its individual citizens and organizations.

A. Factors of Production

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

1. **Labor:** The human resource element in businesses, labor includes the physical and intellectual contributions people make while engaged in economic production.

2. **Capital:** The financial resources needed to operate an enterprise are known as capital.

3. **Entrepreneurs:** An entrepreneur is an individual who accepts the risks and opportunities entailed in creating and operating a new business.

4. **Physical Resources:** The tangible things that organizations use to conduct their business are physical resources and can include raw materials, offices, production facilities, supplies, and computers.

5. **Information Resources:** Businesses rely on information resources, such as market forecasts, the specialized knowledge of people, and economic data.

<u>KEY TEACHING TIPS</u>

- The production of tangible goods once dominated most economic systems. But now, the most important factors of production are entrepreneurial skills and informational resources. The more a country can create an environment that promotes entrepreneurship and harnesses knowledge and information, the better off it will be.

- Remind students that inputs used to produce outputs are also called *factors of production*; they include physical resources, labor, capital, entrepreneurship, and information resources.

<u>QUICK QUESTIONS</u>

- What are the factors of production used to produce orange juice?

- What are the factors of production used to produce an online video game?

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- Entrepreneurship involves tremendous risk-taking and is a welcome ingredient in a free-market system. What characteristics of our free-market system encourage risk taking?

B. Types of Economic Systems

Economic systems vary, depending on how the factors of production are managed.

1. **Planned Economies**: These systems rely on partial or total government control of all or most of the factors of production and allocation decisions. With **communism**—as currently operating in North Korea—all sources of production are owned and operated by the government.

2. **Market Economies**: Producers and consumers control production and allocation decisions through supply and demand. The political basis of a market economy is **capitalism,** which allows the private ownership of the factors of production and encourages entrepreneurship by offering profits as incentives. The economic basis is the operation of demand and supply.

3. **Mixed Market Economies**: This type of economy features characteristics of both planned and market economies; many countries are moving from planned systems to mixed market systems through **privatization,** which involves the transformation of government-controlled businesses into privately owned enterprises. In the partially planned system called **socialism,** the government owns and operates selected major industries. Many Western European countries, including England and France, allow free market operations in most economic areas but keep government control of others, such as health care. The United States currently is wrestling with who should control health care for the portion of the population that is not eligible (by age) for Medicare.

KEY TEACHING TIPS

- Remind students that a government's level of control distinguishes capitalism from socialism. If you have foreign students in your class, you may want them to say a bit about the economic system in their native country.

- Remind students that an *economic system* is defined by how it allocates factors of production. In a *planned economy,* the government owns and controls these factors; in a *market economy,* producers/consumers buy and sell what they choose.

- Make sure students understand that a *mixed market economy* is characterized by government ownership of major industries working alongside privately owned industries.

- Ask students to give their opinions about the health care system in the United States, and the debates regarding restructuring it. In addition, you could ask students to research and report on any new stories concerning the health care system that appear in publications such as the *Wall Street Journal.* It is never too early to get students to regularly read the

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business news!

Use In-Class Activity 3: **Class Discussion: Up for Debate: Comparing Economic Systems Time Limit: 30 Minutes**

QUICK QUESTIONS

- Give an example of a country with a planned economy. What makes this economy planned?

- Give an example of a country with a market economy. How is the economic system different in this country?

- Do you think the government should be involved in supporting the health care insurance system in the U.S.? Why or why not?

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Learning Objective 1-3

Show how markets, demand, and supply affect resource distribution in the United States, identify the elements of private enterprise, and explain the various degrees of competition in the U.S. economic system.

The Economics of Market Systems

Understanding the complex nature of the U.S. economic system is essential to understanding the environment in which U.S. businesses operate. Market systems allow businesses the flexibility to decide what to produce, how much to produce, and what price to charge; customers are a driving force in market systems because they decide what to buy and at what price. Demand and supply are the predominant forces that guide decisions about what to buy and what to sell.

A. Demand and Supply in a Market Economy

Billions of exchanges take place every day between businesses and individuals; between businesses; and among individuals, businesses, and governments. Exchanges conducted in one area often affect exchanges elsewhere.

1. The Laws of Demand and Supply: **Demand** is the willingness and ability of buyers to purchase a product; **supply** is the willingness and ability of producers to offer a good or service for sale. The **law of demand** states that buyers will purchase more of a product as its price drops; the **law of supply** states that producers will offer more of a product for sale as its price increases.

    a. The Demand and Supply Schedule: The **demand** and **supply schedule** indicates how much of a product will be sold at various prices. Generally speaking, the more consumers are willing to pay for a good, the more producers are likely to divert resources to make more of the good. Conversely, as the price at which consumers are willing to pay for a product falls, production becomes less profitable and producers cut back on production to divert resources to more profitable areas.

    b. Demand and Supply Curves: A **demand curve** shows how many products will be demanded at different prices; a **supply curve** shows how many products will be supplied at various prices. The point at which the curves intersect is the **market price** (or **equilibrium price**).

    c. Surpluses and Shortages: With a **surplus,** the quantity supplied exceeds the quantity demanded; quantity demanded exceeds quantity supplied with a **shortage.** Businesses should seek the ideal combination of price charged and quantity supplied so as to maximize profits, maintain goodwill among customers, and discourage competition.

<u>QUICK QUESTION</u>

What is *equilibrium price*? What happens if incomes rise and demand increases? What happens if producers have a surplus and supply increases? Why should producers aim to meet, but not exceed, demand at the equilibrium price?

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B. Private Enterprise and Competition in a Market Economy

Individuals pursue their own interests with minimal government restriction in a **private enterprise** system; such a system requires:

- **Private property rights—**the ability of individuals to own resources
- **Freedom of choice**—the ability to choose where to work and what to buy
- **Profits**—the ability to take risk to earn profit, and
- **Competition—**the ability to compete for customers and scarce resources. Competition occurs when two or more businesses vie for the same resources or customers.

1. **Degrees of Competition.** Economists have identified four degrees of competition in a private enterprise system:

   a. **Perfect Competition.** Many small firms exist in an industry; no single firm is powerful enough to influence price.

   b. **Monopolistic Competition.** Many sellers of all sizes, but also many buyers exist, so sellers focus on numerous differentiation strategies, such as brand names, design, and advertising.

   c. **Oligopoly.** An industry has only a handful of sellers; market entry is difficult because large capital investment is needed. Sellers tend to be large.

   d. **Monopoly**. An industry or market has only one producer; that producer enjoys complete control over price. Utility companies are natural monopolies, industries in which one company can most efficiently supply all needed goods or services. Duplicate facilities would be wasteful.

KEY TEACHING TIPS

- Remind students that *perfect competition* is characterized by (a) many buyers, (b) many sellers, and (c) buyers and sellers who accept a going price.

- Remind students that *monopolistic competition* is characterized by (a) many buyers, (b) many sellers, and (c) products that are differentiated.

- Reinforce that *oligopoly* is characterized by (a) many buyers, (b) few sellers, (c) products that are quite similar, and (d) a change in price by one seller often meaning a change in price by all sellers.

- Remind students that a *monopoly* is characterized by (a) many buyers, (b) only one seller, and (c) prices being set by the one seller.

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QUICK QUESTION

- Which level of competition best describes the market in each of the following scenarios?
  - Your local Pizza Hut (monopolistic competition)
  - A local farmer selling apples for applesauce (perfect competition)
  - Cell phone service (oligopoly)
  - Apple store (monopolistic competition)
  - Local utility/power company (monopoly)

HOMEWORK

Visit a Shopping Mall!
Now is a good time to assign Application Exercise 9 from the end-of-chapter materials as homework. This assignment asks students to visit a local shopping mall and determine the degree of competition stores in the mall face in their immediate environment.

At-Home Completion Time: 1 to 1.5 hours

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Learning Objective 1-4

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

Economic Indicators

A. Economic Indicators

These statistics show whether an economic system is strengthening, weakening, or remaining stable.

1. **Economic Growth, Aggregate Output, and Standard of Living.** The business cycle is the pattern of short-term expansions and contractions in an economy; one important use of economic measures is to help governments and businesses understand where in the business cycle they currently are. **Aggregate output** is the total quantity of goods and services produced by an economic system during a given period. Simply put, an increase in aggregate output is growth. **Standard of living** refers to the total quantity and quality of goods and services that can be purchased with the currency used in an economic system; standard of living increases when the quantity of goods and services increases, and the economic system provides more of the goods and services people want.

2. **Gross Domestic Product (GDP):** The **GDP** is the total value of all goods and services produced within a given period through *domestic* factors of production; GDP is a measurement of aggregate output. If GDP is going up, aggregate output is going up; if aggregate output is going up, the nation is experiencing economic growth. **Gross national product (GNP)** refers to the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located.

   a. **Real Growth Rate:** Real growth depends on output increasing at a faster rate than population; the real growth rate in 2015 of the U.S. economic system was 2.4 percent while the population grew at a rate of 0.70 percent, thus indicating the real growth rate is modest.

   b. **GDP per Capita:** GDP per capita means GDP per person. GDP divided by total population equals GDP per capita. It is a better measure than GDP itself of the economic well-being of the average person.

   c. **Real GDP:** Real GDP means that GDP has been adjusted to account for changes in currency values and price changes. Nominal GDP is GDP measured in current dollars or with all components valued at current prices, with no adjustments made.

   d. **Purchasing Power Parity:** Purchasing power parity is the principle that exchange rates are set so that the prices of similar products in different countries are about the same. It quantifies what people can actually buy with the financial resources allocated to them by their respective economic systems; it gives a better sense of standards of living around the world.

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3. **Productivity:** Productivity compares how much a system produces with the resources needed to produce it; increases in productivity yield increases in the standard of living.

    a. **Balance of Trade:** A country's balance of trade is the economic value of all the products that it exports minus the economic value of its imported products. A *positive* balance results when the value of a country's exports is greater than its imports; that is, more money is flowing into the country as a result of exporting. A *negative* balance results when a country imports more than it exports.

    b. **National Debt:** A country's **national debt** is the amount of money that is owed by the government to creditors.

B. Economic Stability
Stability results when the amount of money available in an economic system and the quantity of goods and services produced in it are growing at about the same rate.

1. **Inflation**. Inflation occurs when widespread price increases plague an economic system; the amount of money in the economic system exceeds the amount of actual output. Inflation can be measured by the **consumer price index (CPI),** which weighs prices of typical products purchased by consumers living in urban areas. Inflation rate equals Change in price index/Initial price index of 100.

2. **Unemployment.** Unemployment is the level of joblessness among people actively seeking work in an economic system; when unemployment is high, a surplus of available workers exists. When unemployment is low, there is a shortage of labor available for businesses to hire.

    Unemployment is sometimes a symptom of a **recession,** when aggregate output declines, or of a **depression,** a prolonged and deep recession. For example, during downturns in the business cycle people in different sectors may lose their jobs at the same time. As a result, overall income and spending may decline to the extent that businesses begin to implement cost saving measures—including reduction in force (downsizing), leading to more unemployment. In early 2010, during the Great Recession, unemployment in the U.S. was 10.2 percent. By November 2011, it was 8.7 percent. By the end of 2016, it was 4.9 percent.

3. **Recession and Depression.** Aggregate output is measured to determine whether an economy is going through a recession. Governments and economists define a **recession** as a period during which aggregate output, as measured by real GDP, declines. The U.S. economy went into a recession in 2008 and many economists agree that we began to emerge in 2011. A prolonged and deep recession is a **depression**.

C. Managing the U.S. Economy
The government manages the U.S. economic system through both fiscal and monetary policies. **Fiscal policies** manage the collection and spending of revenues; changes in tax rates

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can function as fiscal policies. **Monetary policies** focus on controlling the size of the nation's money supply; the government can influence banks to lend money and can influence the supply of money through stimulus packages. **Stabilization policy** is made up of both fiscal and monetary policies; the goal is to smooth out fluctuations in output and unemployment and to stabilize prices.

KEY TEACHING TIPS

- Make sure that students understand that *gross domestic product* includes only the value of products produced *within a nation's borders;* the figure includes the value of products produced by both domestic and foreign companies within those borders.

- Reinforce that *gross national product* includes the value of products produced by a country *regardless of where they are produced;* this figure does *not* include the value of products produced within the country by a foreign company.

- Emphasize that the government regulates the money supply and interest rates through *monetary policy*; the government influences money supply via taxation and spending through *fiscal policy*.

- Make sure students understand that *inflation* occurs when overall price levels go up because too much money is floating around; as a result, purchasing power declines.

HOMEWORK

Interview a Business Owner

Now is a good time to assign Application Exercise 10 from the end-of-chapter materials in the textbook. This assignment asks students to interview a business owner or senior manager and ask them how demand and supply affect their business, what essential factors of production are most central to the firm's operations, and how fluctuations in economic indicators affect their business.

At-Home Completion Time: 1–2 hours

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IN-CLASS ACTIVITIES

In-Class Activity 1: Ice-Breaker: What Do You Know About Business?

Activity Overview:
This activity helps students assess their level of knowledge about business and set their own learning goals for the class.

Time Limit: 20 minutes

What to Do:
1. Ask each student to take out a piece of paper and divide it into two columns. In the first column, students should write the most important four or five things they currently know about business, and in the second column, the four or five things they would like to learn. Tell them that if they are having difficulty coming up with items to list, they should take a look at the table of contents in the text. It will give them some clues so that this task doesn't frustrate them. (5 minutes)

2. Divide students into groups of three to five people and ask them to share their lists with each other. As they listen, they can delete or add anything that seems relevant. (5 minutes)

3. Ask them to switch groups, so that they are with all new people, and repeat the process of sharing their lists. (5 minutes)

4. Ask students to switch to a third group of all new people. With this group, the goal is to synthesize their lists into one big idea of what they know, and one big idea of what they want to learn. (5 minutes)

Don't Forget:
This activity allows students to get to know each other as well as set expectations for the course. The underlying agenda is to get them talking to each other, setting the stage for active participation throughout the class.

Wrap-Up:
Wrap up the discussion by having each group report back to the class. You may want to record their responses and post them in the room for reference as you move through the course.

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In-Class Activity 2: Small Group Discussion: Scanning the Environment

Activity Overview:
This activity asks students to consider how various parts of the external environment affect businesses and industries.

Time Limit: 25 minutes

What to Do:

1. For larger groups, divide the class into four-member groups; for smaller groups, divide the class into two-member groups.

2. Assign each group a specific industry (for example: automotive, airline, fast food, computer, apparel, or restaurant).

3. Ask each group to consider what variables from the technological, political-legal, sociocultural, and economic environments affect their assigned industry. (15 minutes)

4. Ask a spokesperson from each group to share their input. (10 minutes)

Don't Forget:
Remind students that external environmental elements can change dramatically, affecting specific industries differently over time. Remind them that changes can occur quickly or slowly.

Wrap-Up:
Wrap up the discussion by making sure that students understand that the nature of a specific business within an industry and the types and quantities of products/services produced can influence the impact of external environmental variables.

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In-Class Activity 3: Up for Debate: Comparing Economic Systems

Activity Overview:
This activity gets students talking about how similar and different the U.S. economic system is to other systems.

Time Limit: 30 minutes

What to Do:

1. Divide the class into small groups. Ask the groups to assume they have just overheard a classmate say, "The United States is becoming more socialist everyday—with all the government control." Have each group list reasons why the statement could be true and reasons why the statement could be false. (15 minutes)

2. Reassemble the class and discuss each group's thoughts. (15 minutes)

Don't Forget:
Remind students that a government's level of control distinguishes capitalism from socialism. If you have foreign students in your class, you may want them to say a bit about the economic system in their native country.

Wrap-Up:
Wrap up the discussion by reminding students that the U.S. economic system and a socialist system have many similarities and differences. For example, workers in socialist economies often work fewer hours, have longer vacations, and receive more health, education, and child-care benefits than do workers in capitalist economies. On the other hand, the federal government does control some basic services in the United States as well as various aspects of the market through agencies such as the Food and Drug Administration and the Federal Communication Commission.

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ANSWERS FOR END OF CHAPTER ACTIVITIES

QUESTIONS FOR REVIEW

1-1. What are the benefits of businesses? Can a business negatively affect society? Give one example of a business that is benefiting society and one example of a negative effect.

The benefits of businesses are: businesses produce most of the goods and services consumed, employ most working people, create new innovations, and provide opportunities for new businesses to serve as suppliers. Further, businesses contribute to the quality of life and the standard of living.

A business can negatively affect society if it produces goods and services that harm consumers or the environment. An example would be a company that uses a hazardous chemical in its production process and dumps the chemical into a nearby lake causing serious illness. **(Learning Objective 1, AACSB – reflective thinking)**

1-2. What are the factors of production? Is one factor more important than the others? If so, which one? Why?

The five factors of production are labor, capital, entrepreneurs, physical resources, and information resources. All five factors are crucial; however, their relative importance depends on the product and industry. In the software development business, for example, labor and information resources are especially important, but the business couldn't survive without capital and physical resources (computers), and it wouldn't have been launched without an entrepreneur. **(Learning Objective 2 – AACSB – application of knowledge)**

1-3. What is a demand curve? A supply curve? How are they related?

The curve that describes the range of possible prices that a buyer will pay for a range of quantities demanded by a buyer is the *demand curve*. The curve that describes the range of prices that a seller can charge for a range of quantities supplied by the seller is called the *supply curve*. The point where the demand curve and the supply curve intersect is the point at which the intentions of buyers and sellers coincide. The price at this point is the *equilibrium price*. **(Learning Objective 3 – AACSB – application of knowledge)**

1-4. Why is inflation both good and bad? How does the government try to control demand and supply curves?

Inflation is both good and bad because it can lead to a spiral of rising wages chasing rising prices, which decreases the standard of living. It is good because at moderate levels, it can signal the beginning of a period of economic growth. Monetary policy, particularly the ability to adjust interest rates, is government's most powerful tool to control inflation. **(Learning Objective 4 – AACSB – application of knowledge)**

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QUESTIONS FOR ANALYSIS

1-5. Identify and describe at least three factors in the external environment that affect college enrollment. Explain how each trend affects colleges and universities. Explain how each factor may affect college and university enrollment, either by bolstering it or reducing it.

Answers will vary but students will probably discuss trends in birth and unemployment rates as well wage rates. **(Learning Objective 1 – AACSB – application of knowledge)**

1-6. Give an example of a situation in which a surplus of a product led to decreased prices. Similarly, give an example of a situation in which a shortage led to increased prices. What eventually happened in each case? Why?

Answers will vary; however, any clearance sale illustrates the concept of surplus driving down prices. The classic example of a shortage is scalpers selling event tickets at inflated prices. A specific example is Nike's new releases of Air Jordan shoes, in very limited numbers, creating heightened interest and intense demand initially. In both cases, the market eventually determines a price at which all the supply can be sold. **(Learning Objective 3 – AACSB – application of knowledge)**

1-7. Explain how current economic indicators, such as inflation and unemployment, affect you personally. Explain how they may affect you as a manager.

Answers will vary, but all students should include prices paid for consumer goods and the availability of desirable jobs. Managers are affected by inflation because it tends to drive up wages and by unemployment because it affects their ability to find workers. Also, both inflation and unemployment affect consumer and industrial demand, which play a key role in management. **(Learning Objective 4 – AACSB – application of knowledge)**

1-8. How are the overall economic goals of stability and growth related? Can they be reconciled to each other? If so, how?

A nation's economic growth can be measured through its aggregate output, resulting standard of living, GDP, and productivity. Economic stability, on the other hand, refers to the condition in which the amount of money available in an economic system and the quantity of goods and services produced in it are growing at the same rate. Growth is involved in both, thus resolving the apparent inconsistency. **(Learning Objective 4 – AACSB – reflective thinking)**

APPLICATION EXERCISES

1-9. **Visit a Local Shopping Mall:** Visit a local shopping mall or shopping area. List each store that you see and determine what degree of competition it faces in its immediate environment. For example, if only one store in the mall sells shoes, that store represents a "local" monopoly. Note businesses that have direct competitors (for instance, two gas stations right

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next to each other) and show how they compete with one another. Also consider why they might have located right next to each other.

Answers will vary, but students should focus on the criteria for competition discussed in the chapter. For example, businesses with direct competitors operate within monopolistic competition; style, color, quality levels, and brand names often differentiate products. If only a few sellers of a product exist, as in an oligopoly, products will be quite similar, and a change in price by one seller will mean a change in price by all sellers. Also, students should identify areas of concentration of competitors, such as multiple fast-food providers in a limited geographic area, and should discuss probably cause for that, such as appeal to a common demographic, convenience, traffic flow, and simple competitiveness. **(Learning Objective 3 – AACSB – application of knowledge)**

1-10. **Interview a Business Owner:** Interview a business owner or senior manager. Ask this individual to describe for you the following things: (1) how demand and supply affect the business, (2) what essential factors of production are most central to the firm's operations, and (3) how fluctuations in economic indicators affect his or her business.

Answers will vary, but students should recognize that demand and supply affect every business in some way. Typical factors of production cited in this answer include capital, labor, physical resources, information resources, and entrepreneurship. Economic indicators affect businesses differently at different times, depending on whether they are manufacturers or retailers. Ultimately, price increases in an industry will affect the buying power of consumers, which will affect how much is produced and purchased. **(Learning Objective 3 – AACSB – application of knowledge)**

BUILDING A BUSINESS: CONTINUING TEAM EXERCISE 1-11 TO 1-14
(Learning Objectives 2 and 3 – AACSB – interpersonal relations and teamwork, analytical thinking, application of knowledge)

Groups should consider domestic business environment, global business environment, technological environment, political-legal environment, sociocultural environment, and economic environment when identifying three trends that will create business opportunities.

The student should answer the following questions:

- What is my product or service?
- Who are my customers?
- Where are my customers located?
- Is my business idea easily copied?
- If there are substitutes for my product or service, how can I make my product/service stand out from competitors' offerings?
- How can having competition benefit me?

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TEAM EXERCISE: COMPETITION IN THE NEW MOBILE ECONOMY 1-15 TO 1-18 (Learning Objective 3 – AACSB – interpersonal relations and teamwork, analytical thinking, application of knowledge)

1-15. What form of competition best characterizes this market? What characteristics did you identify that led you to that conclusion?

This market is best characterized as monopolistic competition: many sellers, many buyers, and differentiation required to attract buyers. In this scenario, differentiation might include the quality of the coffee, quality of customer service, cleanliness of the shop, and even location. However, students could argue for pure competition, since there is very little room to differentiate one coffee shop from another, causing prices across the board to be fairly uniform. In fact, retail coffee could be considered a commodity.

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

- The average cup of coffee sells for $3 in your area. Right now you are selling 10,000 cups of coffee a month, and your fixed costs, including your own salary and that of your partner, are about $30,000 per month.
- The big chain store around the corner reduced their average sales price per cup to $2.80. As a result, your business falls off by 25 percent.

Scenario 1: Students should point out that the shop is running at break even, and that a price drop may increase demand, but if the market is in relative equilibrium, it is likely that decreasing price will result in an overall decrease in revenue. They may support this assertion mathematically with examples.
Scenario 2: If volume drops by 25%, the company will experience losses, even if it makes up the drop by lowering prices. Students should be creative in their solutions, coming up with different, non-price ways to differentiate the business from the chain stores in order to make up the drop in volume.

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

Inducements will not directly increase overall demand. However, the initiative to take online payments may reduce demand at other stores while increasing demand at the competitor. However, students may identify may be some inducements that cause tea drinkers to switch to coffee, or non-coffee drinkers to take up the habit.

1-18. Is it always in a company’s best interest to feature the lowest prices?

It is definitely not always in a company’s best interest to feature the lowest price. If that is the only point of differentiation between a company’s product and its competitors’ offerings, then customers will perceive that price is the most important differentiation. That will lead to a price war, and, in the long run, no company can win. It is a much better strategy to inform customers of why your product or service is worth paying a higher price.

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EXERCISING YOUR ETHICS: GETTING CAUGHT OUT IN THE COLD
(Learning Objective 2 and 3 – AACSB – ethical understanding and reasoning, reflective thinking)

1-19. What are the roles of supply and demand in this scenario?

Huma anticipates that the supply of heating oil will be higher this winter, resulting in the ability to charge less than last winter. She also believes that demand will increase by offering the ability to lock in a price, as that price is lower than people paid in the past. Paying a fixed price per gallon provides cost certainty to customers. Information resources are an important factor of production that leads to this recommendation.

1-20. What are the underlying ethical issues?

Underlying ethical issues revolve around generating maximum pricing versus generating an acceptable profit, while giving customers an even better deal than the locked in price of $2.40 per gallon.

1-21. What would you do if you were actually faced with this situation?

Answers will vary, but students should at least acknowledge the ethical issues.

CASES:
DOING BUSINESS IN THE GLOBAL MARKETPLACE
(Learning Objectives 3 and 4 – AACSB – application of knowledge, reflective thinking)

1-22. What is the difference between a market economy and a planned economy?

In a market economy, individual producers and consumers control production and allocation by creating combinations of supply and demand. A planned economy relies on a centralized government to control all or most factors of production and to make all or most production and allocation decisions.

1-23. Explain how managers of Alibaba, eBay, Amazon.com, and other online retailers might view the concepts of supply and demand.

Supply is the willingness and ability of producers to offer a good or service for sale. Demand is the willingness and ability of buyers to purchase a product. Retailers, whether online or with physical locations, will attempt to match the supply of a product with the demand for a product, specifically at the equilibrium price. These online merchants may use information resources to quickly react as market forces affect the demand or supply of products.

1-24. What economic indicators would a business owner be most likely to watch, and why?

The economic indicators most likely to be watched are: GDP, productivity, standard of living, and inflation. GDP measures economic growth; standard of living and productivity

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impact the purchasing power of people; inflation can cause wages to rise, but can also lead to increased prices, resulting in a decline in purchasing power.

1-25. Does Jack Ma's success increase or decrease your confidence in a capitalistic system based on private enterprise?

Since China currently is more of a mixed-market economy than a planned economy, it possesses some attributes of a private enterprise system, though the level of government restriction is higher than in a true market economy system. Student answers will vary regarding their level of confidence in a capitalistic system based on private enterprise as they realize how successful Jack Ma has been. They should address the elements of private enterprise as well as the degrees of competition faced.

1-26**.** Should there be more government intervention in the markets and business dealings? Why or why not?

What role would the government play in regulating various industries and markets? There will be much debate about whether there should be government intervention in specific industries. Students should be asked if it is good for competition and society for the government to intervene. The discussion should focus on the long run implications.

GAME THEORY IN THE VIDEO GAME CONSOLE INDUSTRY
(Learning Objectives 1 and 3 – AACSB – application of knowledge, reflective thinking)

1-27. Is it surprising that innovations, breakthroughs, and pricing strategies in the game console market seem to be coordinated? Why, or why not?

Students should focus on the competitive, social, technological, and economic factors that will affect the success or failure of products in the game console market. They should consider why a competitor would change the pricing strategy. It should not be surprising that there seems to be coordination in this market. It is similar to the mobile phone market with which students are very familiar.

1-28. How hard would it be for a new company to get started in the game console industry? Has anyone tried, and if so, what was the result? What are the barriers to entry?

The information provided indicates that it will be very difficult for a new company to succeed, as the Ouya failed within two years of introduction. Barriers to entry include the ability to produce and promote the product and develop enough games to attract attention. After so many years (since 2000), the three brands hold the entire market. There is no reason to expect that to change soon.

1-29. In terms of degrees of competition, how would you describe the market for game consoles? Do you think that this will change in the next five years? If so, how?

Students should focus on the characteristics of the competitive structure and which best fits the video game market. Students should consider what alternatives are available now and

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what alternatives may become available in the future. For example, can online game competition become a viable competitor? What about virtual reality?

1-30. In 2006, Nintendo broke new ground in the video industry with the introduction of the Wii. Sony recently unveiled a virtual reality version of the PS4. If you were a member of the Microsoft marketing and R&D (research and development) team, what advice would you be giving your teammates?

Students will probably have varied responses depending on their perspective on the viability of virtual reality.

1-31. Do you think that having only three manufacturers in this industry is positive or negative? Why?

Since these three manufacturers have controlled the market for so many years, students may not consider it a negative to only have three choices. Similar to mobile phones, users frequently are very loyal to a certain brand.

Once students have answered the questions, discuss their answers as a class. As students discuss their answers, make sure they touch on some of the following points. Technological changes are frequent and sometimes market changing. How much does loyalty matter to users? Do specific features help create loyalty and preference?

1-32. Which game console do you think is superior? Why?

Answers will vary depending on students' experiences with the various consoles and their own personal preferences for game play.

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