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1 Exploring the World of Business and Economics

LEARNING OBJECTIVES

What you will be able to do once you complete this chapter:

1. Discuss what you must do to be successful in the world of business.
2. Define *business* and identify potential risks and rewards.
3. Define *economics* and describe the two types of economic systems: capitalism and command economy.
4. Identify the ways to measure economic performance.
5. Examine the different phases in the typical business cycle.
6. Outline the four types of competition.
7. Summarize the factors that affect the business environment and the challenges that American businesses will encounter in the future.

Inside BUSINESS

Zynga Zooms into Business

Zynga, named for its founder's American bulldog, is the fast-growing business behind some of the social media world's fastest-growing games. If you've ever tended crops on FarmVille, you know how addictive a Zynga game can be. Even though FarmVille was developed and launched in only six weeks, it instantly captured the imagination of millions of players who eagerly logged onto their Facebook accounts to plant trees or exchange seeds with "neighbors." Other popular Zynga games include CityVille, CastleVille, and Words with Friends.

Founder and CEO Mark Pincus is a seasoned entrepreneur who earned an MBA from Harvard University. Before Zynga, he had started four other Internet businesses—and earned millions of dollars from their success. In 2007, he came up with the idea for a game business in which players could get ahead by connecting with friends (think "neighbors" in FarmVille) and buying special items (such as virtual tractors and cows) that would give them a competitive edge.

Now, when players worldwide buy digital tractors and cows in FarmVille, they can pay with real money, which is why Zynga's profits are real. So real, in fact, that on the basis of its track record, Zynga was able to go public and sell shares of its corporate stock in December, 2011.

As Zynga continues to grow, Pincus and his managers are keeping their workforce satisfied by offering benefits such as surprise vacations and by making the workplace as comfortable as possible. Like many other high-tech firms, Zynga offers free lunch and dinner. Dogs are welcome at the San Francisco headquarters (and they get free dog nibbles, too). Employees can grab a cup of fresh-brewed espresso at the office's gourmet coffee station, sip tea in the Zen-style tea garden, work out in the fitness center, or take a break to play arcade games in the company lounge.

In today's fast-paced business environment, the online games that get everyone talking and clicking right now can become has-beens as soon as the next new thing comes to market. That's why Pincus and his entire team are working hard to keep Zynga zooming ahead year after year.[1]

FYI

Did You Know?

Zynga's CityVille game is the fastest-growing online game in history, attracting more than 84 million players within its first month of release on Facebook.

Wow! What a challenging world we live in. Just for a moment, think about the economic problems listed here and how they affect not only you, but also businesses in the United States and the global economy.

- U.S. unemployment rates hovering around 8 percent
- Reduced spending by worried consumers
- Increased government spending to stimulate a troubled economy that created the largest national debt in the nation's history
- A volatile stock market and concerns about banks and financial institutions
- Reform movements including the "Occupy Wall Street" movement that protest differences in wealth and income

In fact, just about every person around the globe was affected in some way by the economic crisis that began in late 2007. Despite the efforts of the U.S. government and other world governments to provide the economic stimulus needed to stabilize the economy, it took nearly four years before the economy began to improve. Today, even with signs of modest improvement, people still worry about their economic future and the future of the nation. Hopefully, by the time you read this material, the nation's economy will be much stronger. Still, it is important to remember the old adage, "History is a great teacher." Both the nation and individuals should take a look at what went wrong to avoid making the same mistakes in the future.

In addition, it helps to keep one factor in mind: Our economy continues to adapt and change to meet the challenges of an ever-changing world and to provide opportunities for those who want to achieve success. Our economic system provides an amazing amount of freedom that allows businesses like Zynga—the Internet gaming company profiled in the Inside Business opening case for this chapter—to adapt to changing business environments. Despite troubling economic times and a weak economy, Zynga—and its 3,000 employees—is a success because it was able to introduce new games that players love, earn a profit, and sell stock to the general public.

Within certain limits, imposed mainly to ensure public safety, the owners of a business can produce any legal good or service they choose and attempt to sell it at the price they set. This system of business, in which individuals decide what to produce, how to produce it, and at what price to sell it, is called **free enterprise**. Our free-enterprise system ensures, for example, that Amazon.com can sell everything from televisions, toys, and tools to computers, cameras, and clothing. Our system gives Amazon's owners and stockholders the right to make a profit from the company's success. It gives Amazon's management the right to compete with bookstore rival Barnes & Noble and electronics giant Sony. It also gives you the right to choose.

In this chapter, we look briefly at what business is and how it became that way. First, we discuss what you must do to be successful in the world of business and explore some important reasons for studying business. Then we define *business*, noting how business organizations satisfy their customers' needs and earn profits. Next, we examine how capitalism and command economies answer four basic economic questions. Then our focus shifts to how the nations of the world measure economic performance, the phases in a typical business cycle, and the four types of competitive situations. Next, we look at the events that helped shape today's business system, the current business environment, and the challenges that businesses face.

YOUR FUTURE IN THE CHANGING WORLD OF BUSINESS

Discuss what you must do to be successful in the world of business. 1

The key word in this heading is *changing*. When faced with both economic problems and increasing competition not only from firms in the United States but also from international firms located in other parts of the world, employees and managers began to ask the question: What do we do now? Although this is a fair question, it is difficult to answer. Certainly, for a college student taking business courses or an employee just starting a career, the question is even more difficult to answer. Yet there are still opportunities out there for people who are willing to work hard, continue to learn, and possess the ability to adapt to change. Let's begin our discussion in this section with three basic concepts.

- What do you want?
- Why do you want it?
- Write it down!

During a segment on a national television talk show, Joe Dudley, one of the world's most respected black business owners, gave the preceding advice to anyone who wanted to succeed in business. His advice can help you achieve success. What is so amazing about Dudley's success is that he started a manufacturing business in his own kitchen, with his wife and children serving as the new firm's only employees. He went on to develop his own line of hair-care and cosmetic products sold directly to cosmetologists, barbers, beauty schools, and consumers in the United States and 18 foreign countries. Today, Mr. Dudley has a multimillion-dollar empire—one of the

free enterprise the system of business in which individuals are free to decide what to produce, how to produce it, and at what price to sell it most successful minority-owned companies in the nation. He is not only a successful business owner but also a winner of the Horatio Alger Award—an award given to outstanding individuals who have succeeded in the face of adversity.[2]

Although many people would say that Joe Dudley was just lucky or happened to be in the right place at the right time, the truth is that he became a success because he had a dream and worked hard to turn his dream into a reality. Today, Dudley's vision is to see people succeed—to realize "The American Dream." He would be the first to tell you that you have the same opportunities that he had. According to Mr. Dudley, "Success is a journey, not just a destination."[3]

Whether you want to obtain part-time employment to pay college and living expenses, begin your career as a full-time employee, or start a business, you must *bring* something to the table that makes you different from the next person. Employers and our economic system are more demanding than ever before. Ask yourself: What can I do that will make employers want to pay me a salary? What skills do I have that employers need? With these two questions in mind, we begin the next section with another basic question: Why study business?

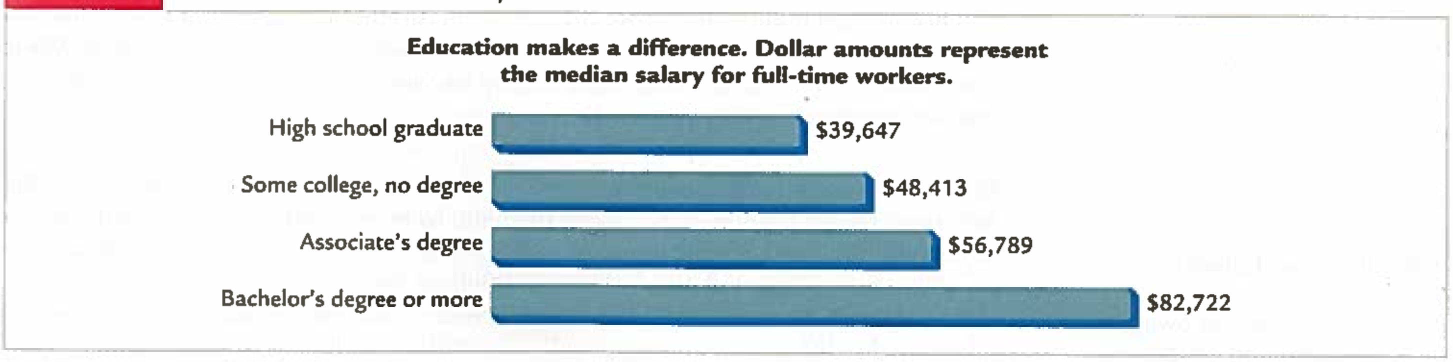
Why Study Business?

The potential benefits of higher education are enormous. To begin with, there are economic benefits. Over their lifetimes, college graduates on average earn much more than high school graduates. Although lifetime earnings are substantially higher for college graduates, so are annual income amounts (see Figure 1.1). In addition to higher income, you will find at least five compelling reasons for studying business.

For Help in Choosing a Career What do you want to do with the rest of your life? At some time in your life, someone probably has asked you this same question. Like many people, you may find it a difficult question to answer. This business course will introduce you to a wide array of employment opportunities. In private enterprise, these range from small, local businesses owned by one individual to large companies such as American Express and Marriott International that are owned by thousands of stockholders. There are also employment opportunities with federal, state, county, and local governments and with charitable organizations such as the Red Cross and Save the Children. For help in deciding which career might be right for you, read Appendix A: Careers in Business, which appears on the text Web site. To view this information:

1. Go to www.cengagebrain.com.
2. At the CengageBrain.com home page, search for the ISBN for your book (located on the back cover of your book) using the search box at the top of the page. This will take you to the product page where free companion resources can be found.

FIGURE 1.1 Who Makes the Most Money?



Source: The 2012 Statistical Abstract of the U.S. Web site at www.census.gov (accessed January 10, 2012). Salary amounts were obtained from Table 692.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Career SUCCESS

Show Off Your Skills with Digital Merit Badges

Made of pixels instead of fabric, the next generation of merit badges is on its way, bringing new possibilities for showing off your skills via digital badges on your Web site, blog, or Facebook page. The point is to encourage students, career-changers, veterans, and learners of all ages to acquire or polish skills that can be helpful in career moves and in life. Whether you're just entering the workforce or you want to branch out into a new field, take a look at what digital merit badges have to offer.

The MacArthur Foundation is partnering with organizations such as the Smithsonian and the U.S. Department of Veterans Affairs to encourage and recognize skill attainment in a variety of areas through its "Badges for Lifelong Learning" program. In the works are badges for financial literacy, engineering design, filmmaking, mathematics proficiency, natural history, and military experience. "The badges are another way to tell the story of who you are and what you know," explains a MacArthur executive.

TopCoder, a Connecticut company, awards digital badges (and cash) to those who earn top scores in its international programming competitions. NASA has teamed up with the Boy Scouts of America and the Girl Scouts of America to offer badges in robotics. Is a digital merit badge in your future?

Sources: Based on information in Anne Eisenberg, "For Job Hunters, Digital Merit Badges," *New York Times*, November 20, 2011, p. BU-3; Sam Kilb, "Credentials, the Next Generation," *New York Times Education Life*, November 6, 2011, p. 10; Leslie Katz, "Boy Scouts Can Now Earn Robotics Merit Badge," *Cnet News*, April 10, 2011, http://news.cnet.com.

In addition to career information in Appendix A, a number of additional Web sites provide information about career development. For more information, visit the following sites:

- Career Builder at www.careerbuilder.com
- Career One Stop at www.careeronestop.org
- Monster at www.monster.com

To click your career into high gear, you can also use online networking to advance your career. Web sites like Facebook, Twitter, LinkedIn, and other social media sites can help you locate job openings, help prospective employers to find you, and make a good impression on current and future bosses. To make the most of online networking, begin by identifying and joining sites where you can connect with potential employers, former classmates, and others who may have or may hear of job openings. Next, be sure your online profiles, photographs, and posts communicate your abilities and interest without being offensive or overly revealing. Finally, be ready to respond quickly when you spot a job opening.

One thing to remember as you think about what your ideal career might be is that a person's choice of a career ultimately is just a reflection of what he or she values and holds most important. What will give one individual personal satisfaction may not satisfy another. For example, one person may dream of a career as a corporate executive and becoming a millionaire before the age of 30. Another may choose a career that has more modest monetary rewards but that provides the opportunity to help others. What you choose to do with your life will be based on what you feel is most important. And *you* are a very important part of that decision.

cultural (or workplace) diversity differences among people in a workforce owing to race, ethnicity, and gender

To Be a Successful Employee Deciding on the type of career you want is only the first step. To get a job in your chosen field and to be successful at it, you will have to develop a plan, or a road map, that ensures that you have the skills and knowledge the job requires. You will also be expected to have the ability to work well with many types of people in a culturally diverse workforce. **Cultural (or workplace) diversity** refers to the differences among people in a workforce owing to race, ethnicity, and gender. These skills, together with a working knowledge of the American business system and an appreciation for a culturally diverse workplace, can give you an inside edge when you are interviewing with a prospective employer.

This course, your instructor, and all of the resources available at your college or university can help you to acquire the skills and knowledge you will need for a successful career. But do not underestimate your part in making your dream a reality. In addition to the job-related skills and knowledge you'll need to be successful in a specific job, employers will also look for the following characteristics when hiring a new employee or promoting an existing employee:

- Honesty and integrity
- Willingness to work hard
- Dependability
- Time management skills
- Self-confidence
- Motivation
- Willingness to learn
- Communication skills
- Professionalism

Employers will also be interested in any work experience you may have had in cooperative work/school programs, during summer vacations, or in part-time jobs during the school year. These things can make a difference when it is time to apply for the job you really want.

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Personal APPS

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Sometimes you have to reach for success! There's an old saying that if you choose a career you like, you never have to work a day in your life. For most people, the first decision is choosing a career. Then the material in the sections "To Be a Successful Employee" and "To Improve Your Management Skills" can help you achieve success.

To Improve Your Management Skills Often, employees become managers or supervisors. In fact, many employees want to become managers because managers often receive higher salaries. Although management obviously can be a rewarding career, what is not so obvious is the amount of time and hard work needed to achieve the higher salaries. For starters, employers expect more from managers and supervisors than ever before. Typically, the heavy workload requires that managers work long hours, and most do not get paid overtime. They also face increased problems created by the economic crisis, increased competition, employee downsizing, the quest for improved quality, and the need for efficient use of the firm's resources.

To be an effective manager, managers must be able to perform four basic management functions: planning, organizing, leading and motivating, and controlling. All four topics are discussed in Chapter 6, Understanding the Management Process. To successfully perform these management functions, managers must possess four very important skills.

- *Interpersonal skills*—The ability to deal effectively with individual employees, other managers within the firm, and people outside the firm.
- *Analytic skills*—The ability to identify problems correctly, generate reasonable alternatives, and select the "best" alternatives to solve problems.
- *Technical skills*—The skill required to accomplish a specific kind of work being done in an organization. Although managers may not actually perform the technical tasks, they should be able to train employees and answer technical questions.
- *Conceptual skills*—The ability to think in abstract terms in order to see the "big picture." Conceptual skills help managers understand how the various parts of an organization or idea can fit together.

In addition to the four skills just described, a successful manager will need many of the same characteristics that an employee needs to be successful.

To Start Your Own Business Some people prefer to work for themselves, and they open their own businesses. To be successful, business owners must possess many of the same characteristics that successful employees have, and they must be willing to work hard and put in long hours.

It also helps if your small business can provide a product or service that customers want. For example, Steve Demeter, the CEO and founder of the software development firm Demiforce, began his career by creating the *Trism* application for the Apple iPhone. *Trism* was an immediate sensation and sold 50,000 copies at $4.99 in its first two months on Apple's AppStore. Now Demeter and the employees at Demiforce are working with a number of promising ideas in the works all with one goal in mind: to provide games and applications that people want.[4]

Unfortunately, many small-business firms fail: Approximately 70 percent of them fail within the first ten years. Typical reasons for business failures include undercapitalization (not enough money), poor business location, poor customer service, unqualified or untrained employees, fraud, lack of a proper business plan, and failure to seek outside professional help. The material in Chapter 5, Small Business, Entrepreneurship, and Franchises, and selected topics and examples throughout this text will help you to decide whether you want to open your own business. This material will also help you to overcome many of these problems.

To Become a Better Informed Consumer and Investor The world of business surrounds us. You cannot buy a home, a new Ford Fusion Hybrid from the local Ford dealer, a pair of jeans at Gap Inc., or a hot dog from a street vendor without entering a business transaction. Because you no doubt will engage in business transactions almost every day of your life, one very good reason for studying business is to become a more fully informed consumer.

Many people also rely on a basic understanding of business to help them to invest for the future. According to Julie Stav, Hispanic stockbroker-turned-author/radio personality, "Take $25, add to it drive plus determination and then watch it multiply into an empire."[5] The author of *Get Your Share* believes that it is important to learn the basics about the economy and business, stocks, mutual funds, and other alternatives before investing your money. She also believes that it is never too early to start investing. Although this is an obvious conclusion, just dreaming of being rich does not make it happen. In fact, like many facets of life, it takes planning and determination to establish the type of investment program that will help you to accomplish your financial goals.

Special Note to Business Students

It is important to begin reading this text with one thing in mind: *This business course does not have to be difficult.* We have done everything possible to eliminate the problems that you encounter in a typical class. All of the features in each chapter have been evaluated and recommended by instructors with years of teaching experience. In addition, business students were asked to critique each chapter component. Based on this feedback, the text includes the following features:

- *Learning objectives* appear at the beginning of each chapter.
- *Inside Business* is a chapter-opening case that highlights how successful companies do business on a day-to-day basis.
- *Margin notes* are used throughout the text to reinforce both learning objectives and key terms.
- *Two boxed features* in each chapter chosen from Career Success, Entrepreneurial Success, Ethical Success or Failure?, and Going for Success highlight how both employees and entrepreneurs can be successful.

- *Two Personal Apps* in each chapter provide special student-centered examples and explanations that help you immediately grasp and retain the material.
- *Sustaining the Planet* features provide information about companies working to protect the environment.
- *Social Media* features provide examples of how businesses and individuals are using social networking and social media sites.
- *End-of-chapter materials* provide questions about the opening case, a chapter summary, a list of key terms, review and discussion questions, and two cases.
- The last section of every chapter is entitled Building Skills for Career Success and includes exercises devoted to enhancing your social media skills, building communication skills with a journal exercise, developing critical-thinking skills, building team skills, and researching different careers.
- *End-of-part materials* provide a continuing video case about Graeter's Ice Cream, a company that operates a chain of retail outlets in the Cincinnati, Ohio, area and sells to Kroger Stores throughout the country. Also, at the end of each major part is an exercise designed to help you to develop the components that are included in a typical business plan.

In addition to the text, a number of student supplements will help you to explore the world of business. We are especially proud of the Web site that accompanies this edition. There, you will find online study aids, such as interactive quizzes, key terms and definitions, student PowerPoint slides, crossword puzzles, and links to the videos for each chapter. If you want to take a look at the Internet support materials available for this edition of *Business*,

1. Go to www.cengagebrain.com.
2. At the CengageBrain.com home page, search for the ISBN for your book (located on the back cover of your book) using the search box at the top of the page. This will take you to the textbook Web site where free companion resources can be found.

As authors, we want you to be successful. We know that your time is valuable and that your schedule is crowded with many different activities. We also appreciate the fact that textbooks are expensive. Therefore, we want you to use this text and get the most out of your investment. To help you get off to a good start, a number of suggestions for developing effective study skills and using this text are provided in Table 1.1.

TABLE 1.1 Seven Ways to Use this Text and Its Resources

1. Prepare before you go to class.	Early preparation is the key to success in many of life's activities. Certainly, early preparation can help you to participate in class, ask questions, and improve your performance on examinations.
2. Read the chapter.	Although it may seem like an obvious suggestion, many students never take the time to really read the material. Find a quiet space where there are no distractions, and invest enough time to become a "content expert."
3. Underline or highlight important concepts.	Make this text yours. Do not be afraid to write on the pages of your text or highlight important material. It is much easier to review material if you have identified important concepts.
4. Take notes.	While reading, take the time to jot down important points and summarize concepts in your own words. Also, take notes in class.
5. Apply the concepts.	Learning is always easier if you can apply the content to your real-life situation. Think about how you could use the material either now or in the future.
6. Practice critical thinking.	Test the material in the text. Do the concepts make sense? To build critical-thinking skills, answer the questions that accompany the cases at the end of each chapter. Also, many of the exercises in the Building Skills for Career Success require critical thinking.
7. Prepare for the examinations.	Allow enough time to review the material before the examinations. Check out the summary and review questions at the end of the chapter. Then use the resources on the text Web site.

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Why not take a look at these suggestions and use them to help you succeed in this course and earn a higher grade. Remember what Joe Dudley said, "Success is a journey, not just a destination."

Because a text should always be evaluated by the students and instructors who use it, we would welcome and sincerely appreciate your comments and suggestions. Please feel free to contact us by using one of the following e-mail addresses:

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Jack Kapoor: kapoorj@cod.edu

Define *business* and identify potential risks and rewards. 2

BUSINESS: A DEFINITION

Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs. The general term *business* refers to all such efforts within a society (as in "American business"). However, *a business* is a particular organization, such as Kraft Foods, Inc., or Cracker Barrel Old Country Stores. To be successful, a business must perform three activities. It must be organized, it must satisfy needs, and it must earn a profit.

business the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs

The Organized Effort of Individuals

For a business to be organized, it must combine four kinds of resources: material, human, financial, and informational. *Material* resources include the raw materials used in manufacturing processes as well as buildings and machinery. For example, Sara Lee (now part of Hillshire Brands) needs flour, sugar, butter, eggs, and other raw materials to produce the food products it sells worldwide. In addition, this Illinois-based company needs human, financial, and informational resources. *Human* resources are the people who furnish their labor to the business in return for wages. The *financial* resource is the money required to pay employees, purchase materials, and generally keep the business operating. *Information* is the resource that tells the managers of the business how effectively the other three resources are being combined and used (see Figure 1.2).

Today, businesses are usually organized as one of three specific types. *Service businesses* produce services, such as haircuts, legal advice, or tax preparation. H&R Block provides tax preparation, retail banking, and various business advisory and consulting services in the United States, Canada, and Australia. *Manufacturing businesses* process various materials into tangible goods, such as delivery trucks, towels, or computers. Intel, for example, produces computer chips that, in turn, are sold to companies that manufacture computers. Finally, some firms called *marketing intermediaries* buy products from manufacturers and then resell them. Sony Corporation is a manufacturer that produces stereo equipment, televisions, and other electronic products. These products may be sold to a marketing intermediary such as Best Buy or Walmart, which then resells the manufactured goods to consumers in their retail stores.


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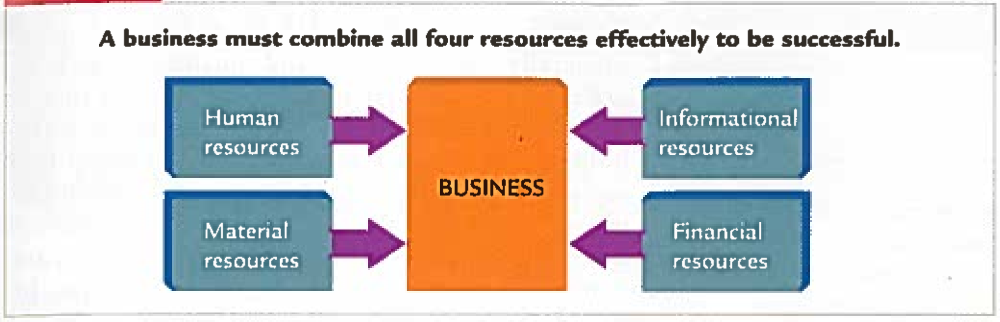
Organization when it counts. Imagine what would happen if the medical professionals in a hospital operating room weren't organized—especially if you were the patient. Like a surgical operating room, a business must be organized in order to meet the needs of its customers and earn a profit.

Satisfying Needs

The ultimate objective of every firm must be to satisfy the needs of its customers. People generally do not buy goods and services simply to own them; they buy goods and services to satisfy

FIGURE 1.2 Combining Resources



particular needs. Some of us may feel that the need for transportation is best satisfied by an air-conditioned BMW with navigation system, stereo system, heated and cooled seats, automatic transmission, power windows, and remote-control side mirrors. Others may believe that a Chevrolet Sonic with a stick shift will do just fine. Both products are available to those who want them, along with a wide variety of other products that satisfy the need for transportation.

When firms lose sight of their customers' needs, they are likely to find the going rough. However, when businesses understand their customers' needs and work to satisfy those needs, they are usually successful. Back in 1962, Sam Walton opened his first discount store in Rogers, Arkansas. Although the original store was quite different from the Walmart Superstores you see today, the basic ideas of providing customer service and offering goods that satisfied needs at low prices are part of the reason why this firm has grown to become the largest retailer in the world. Although Walmart has over 10,000 stores in the United States and 27 other countries, this highly successful discount-store organization continues to open new stores to meet the needs of its customers around the globe.[6]

Business Profit

A business receives money (sales revenue) from its customers in exchange for goods or services. It must also pay out money to cover the expenses involved in doing business. If the firm's sales revenues are greater than its expenses, it has earned a profit. More specifically, as shown in Figure 1.3, **profit** is what remains after all business expenses have been deducted from sales revenue.

A negative profit, which results when a firm's expenses are greater than its sales revenue, is called a *loss*. A business cannot continue to operate at a loss for an indefinite period of time. Management and employees must find some way to increase sales revenues and reduce expenses to return to profitability. If some

FIGURE 1.3 The Relationship Between Sales Revenue and Profit

profit what remains after all business expenses have been deducted from sales revenue

Sustaining the PLANET

Honda: Not Just Another Automobile Manufacturer

When you hear the name Honda, you typically think about automobiles. But Honda is much more than that. Honda product lines include motorcycles, financial services, and even walk assist devices to help the disabled. The company continues to innovate and create products with a global perspective but they balance innovation with a commitment to the preservation of the environment both globally and in the local communities where they operate. Take a look at http://corporate.honda.com/innovation/ or http://corporate.honda.com/environment/.

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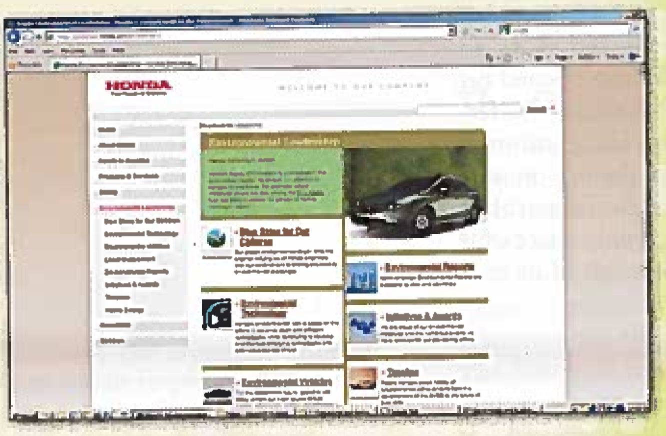

HTTP://CORPORATE.HONDA.COM

specific actions are not taken to eliminate losses, a firm may be forced to close its doors or file for bankruptcy protection. Although many people—especially stockholders and business owners—believe that profit is literally the bottom line or most important goal for a business, many stakeholders may be just as concerned about a firm's social responsibility record. The term **stakeholders** is used to describe all the different people or groups of people who are affected by the policies, decisions, and activities made by an organization. Many corporations, for example, are careful to point out their efforts to sustain the planet, participate in the green ecological movement, and help people to live better lives in an annual social responsibility report. In its 86-page social responsibility report, General Mills describes how it contributed $100 million in 2010—a 10 percent increase when compared to 2009—to a wide variety of causes, including support for programs that feed the hungry and non-profit organizations in the United States and around the globe.[7] Although stockholders and business owners sometimes argue that the money that a business contributes to charitable causes could have been used to pay larger dividends to stockholders or increase the return on the owners' investment, the fact is that most socially responsible business firms feel social responsibility is the right thing to do and is good for business.

The profit earned by a business becomes the property of its owners. Thus, in one sense, profit is the reward business owners receive for producing goods and services that customers want. Profit is also the payment that business owners receive for assuming the considerable risks of business ownership. One of these is the risk of not being paid. Everyone else—employees, suppliers, and lenders—must be paid before the owners.

A second risk that owners undertake is the risk of losing whatever they have invested into the business. A business that cannot earn a profit is very likely to fail, in which case the owners lose whatever money, effort, and time they have invested.

To satisfy society's needs and make a profit, a business must operate within the parameters of a nation's economic system. In the next section, we define economics and describe two different types of economic systems.

③ Define *economics* and describe the two types of economic systems: capitalism and command economy.

TYPES OF ECONOMIC SYSTEMS

Economics is the study of how wealth is created and distributed. By *wealth*, we mean "anything of value," including the goods and services produced and sold by business. *How wealth is distributed* simply means "who gets what." Experts often use economics to explain the choices we make and how these choices change as we cope with the demands of everyday life. In simple terms, individuals, businesses, governments, and society must make decisions that reflect what is important to each group at a particular time. For example, suppose you want to take a weekend trip to some exotic vacation spot, and you also want to begin an investment program. Because of your

stakeholders all the different people or groups of people who are affected by the policies and decisions made by an organization

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Entrepreneurial SUCCESS

Building a Million-Dollar App Business

Nick D'Aloisio, who lives in the south of London, England, created his first iPhone app when he was 12. Two apps later, teen entrepreneur D'Aloisio hit upon a new app idea that has brought him into the major leagues of the app business world.

D'Aloisio was searching the Internet for information for a term paper when he realized how much time it takes to determine the content of each web page. To speed things up, he developed an algorithm that summarizes the key points in a few words. He named this app Trimit, priced it at 99 cents per download, released it on Apple's App Store, and earned $1,600 within the first three days.

To accelerate Trimit's momentum, D'Aloisio decided to give it away instead of charging for it. The app's download numbers skyrocketed, bringing it to the attention of Horizon Ventures, a firm that invests in businesses when they're in the early stages of growth. Horizon invested $250,000 to commercialize the app, which was renamed Summly and relaunched a few months later. As Summly, the app was downloaded 30,000 times in the first week alone, putting D'Aloisio squarely on the path toward his goal of building a $1 million app business.

Sources: Based on information in Jane Wakefield, "British Teenage Designer of Summly App Hits Jackpot," *BBC News*, December 28, 2011, www.bbc.co.uk; Parmy Olson, "Teen Programmer Hopes to Make a Million from A.I. App," *Forbes*, September 1, 2011, www.forbes.com; Kit Eaton, "The 15-year-old Creator of the Trimit App Makes Regular Old Entrepreneurs Seem Like Slackers," *Fast Company*, August 11, 2011, www.fastcompany.com.

financial resources, though, you cannot do both, so you must decide what is most important. Business firms, governments, and to some extent society face the same types of decisions. Each group must deal with scarcity when making important decisions. In this case, *scarcity* means "lack of resources"—money, time, natural resources, and so on—that are needed to satisfy a want or need.

Today, experts often study economic problems from two different perspectives: microeconomics and macroeconomics. **Microeconomics** is the study of the decisions made by individuals and businesses. Microeconomics, for example, examines how the prices of homes affect the number of homes individuals will buy. On the other hand, **macroeconomics** is the study of the national economy and the global economy. Macroeconomics examines the economic effect of national income, unemployment, inflation, taxes, government spending, interest rates, and similar factors on a nation and society.

economics the study of how wealth is created and distributed

microeconomics the study of the decisions made by individuals and businesses

macroeconomics the study of the national economy and the global economy

economy the way in which people deal with the creation and distribution of wealth

factors of production resources used to produce goods and services

The decisions that individuals, business firms, government, and society make, and the way in which people deal with the creation and distribution of wealth determine the kind of economic system, or **economy**, that a nation has.

Over the years, the economic systems of the world have differed in essentially two ways: (1) the ownership of the factors of production and (2) how they answer four basic economic questions that direct a nation's economic activity.

Factors of production are the resources used to produce goods and services. There are four such factors:

- *Land and natural resources*—elements that can be used in the production process to make appliances, automobiles, and other products. Typical examples include crude oil, forests, minerals, land, water, and even air.
- *Labor*—the time and effort that we use to produce goods and services. It includes human resources such as managers and employees.
- *Capital*—the money, facilities, equipment, and machines used in the operation of organizations. Although most people think of capital as just money, it can also be the manufacturing equipment in a Pepperidge Farm production facility or a computer used in the corporate offices of McDonald's.

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Saving natural resources one bus at a time. While "green" used to refer to a color in a box of crayons, now it has taken on a whole new meaning. For consumers, the government, *and* businesses, green means a new way to save natural resources, to protect the environment, and often to reduce our dependence on oil from foreign countries.

- *Entrepreneurship*—the activity that organizes land, labor, and capital. It is the willingness to take risks and the knowledge and ability to use the other factors of production efficiently. An **entrepreneur** is a person who risks his or her time, effort, and money to start and operate a business.

A nation's economic system significantly affects all the economic activities of its citizens and organizations. This far-reaching impact becomes more apparent when we consider that a country's economic system determines how the factors of production are used to meet the needs of society. Today, two different economic systems exist: capitalism and command economies. The way each system answers the four basic economic questions listed here determines a nation's economy.

1. *What* goods and services—and how much of each—will be produced?
2. *How* will these goods and services be produced?
3. *For whom* will these goods and services be produced?
4. *Who* owns and who controls the major factors of production?

Capitalism

Capitalism is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Capitalism stems from the theories of the 18th-century Scottish economist Adam Smith. In his book *Wealth of Nations*, published in 1776, Smith argued that a society's interests are best served when the individuals within that society are allowed to pursue their own self-interest. According to Smith, when individuals act to improve their own fortunes, they indirectly promote the good of their community and the people in that community. Smith went on to call this concept the "invisible hand." The **invisible hand** is a term created by Adam Smith to describe how an individual's own personal gain benefits others and a nation's economy. For example, the only way a small-business owner who produces shoes can increase personal wealth is to sell shoes to customers. To become even more prosperous, the small-business owner must hire workers to produce even more shoes. According to the invisible hand, people in the small-business owner's community not only would have shoes but also would have jobs working for the shoemaker. Thus, the success of people in the community and, to some extent, the nation's economy is tied indirectly to the success of the small-business owner.

Adam Smith's capitalism is based on the following fundamental issues—also see Figure 1.4.

1. The creation of wealth is properly the concern of private individuals, not the government.
2. Private individuals must own private property and the resources used to create wealth.
3. Economic freedom ensures the existence of competitive markets that allow both sellers and buyers to enter and exit the market as they choose.
4. The role of government should be limited to providing defense against foreign enemies, ensuring internal order, and furnishing public works and education.

entrepreneur a person who risks time, effort, and money to start and operate a business

capitalism an economic system in which individuals own and operate the majority of businesses that provide goods and services

invisible hand a term created by Adam Smith to describe how an individual's personal gain benefits others and a nation's economy

FIGURE 1.4 Basic Assumptions for Adam Smith's Laissez-Faire Capitalism

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One factor that Smith felt was extremely important was the role of government. He believed that government should act only as rule maker and umpire. The French term *laissez faire* describes Smith's capitalistic system and implies that there should be no government interference in the economy. Loosely translated, this term means "let them do" (as they see fit).

Adam Smith's laissez-faire capitalism is also based on the concept of a market economy. A **market economy** (sometimes referred to as a *free-market economy*) is an economic system in which businesses and individuals decide what to produce and buy, and the market determines prices and quantities sold. The owners of resources should be free to determine how these resources are used and also to enjoy the income, profits, and other benefits derived from ownership of these resources.

Capitalism in the United States

Our economic system is rooted in the laissez-faire capitalism of Adam Smith. However, our real-world economy is not as laissez-faire as Smith would have liked because government participates as more than umpire and rule maker. Our economy is, in fact, a **mixed economy**, one that exhibits elements of both capitalism and socialism.

In a mixed economy, the four basic economic questions discussed at the beginning of this section (*what, how, for whom,* and *who*) are answered through the interaction of households, businesses, and governments. The interactions among these three groups are shown in Figure 1.5.

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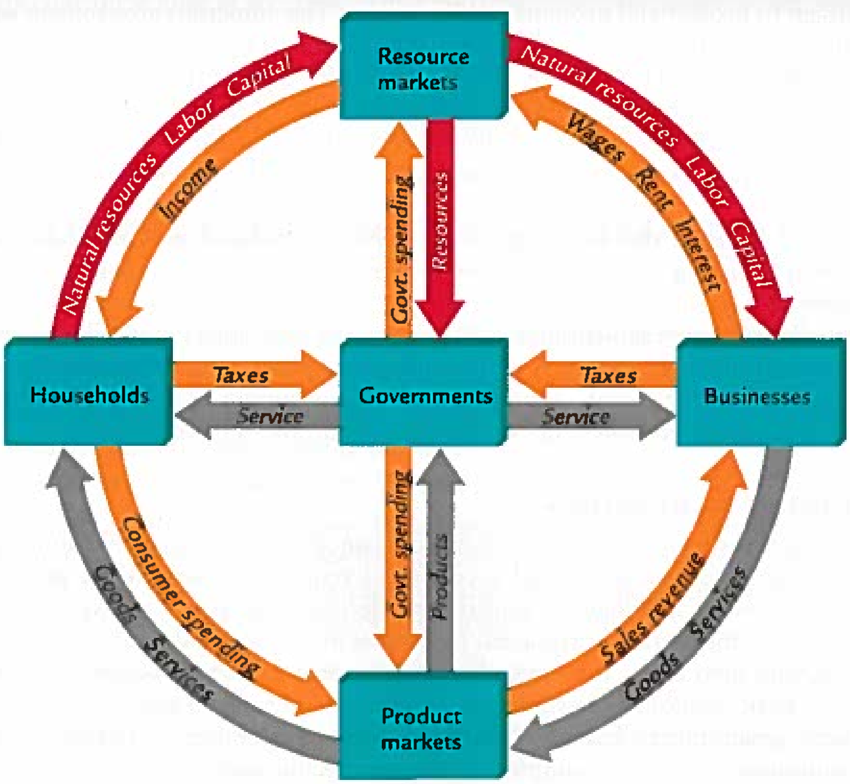
An apple a day . . . Regarded as one of the most successful and profitable businesses in the very competitive technology industry, Apple has a history of introducing state-of-the-art consumer products like the iPhone and iPad. Although there are many ways to obtain Apple products, one way to "try out" the latest products is to visit one of their retail stores.

FIGURE 1.5 The Circular Flow in Our Mixed Economy

Our economic system is guided by the interaction of buyers and sellers, with the role of government being taken into account.



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market economy an economic system in which businesses and individuals decide what to produce and buy, and the market determines quantities sold and prices

mixed economy an economy that exhibits elements of both capitalism and socialism

Households Households, made up of individuals, are the consumers of goods and services as well as owners of some of the factors of production. As *resource owners,* the members of households provide businesses with labor, capital, and other resources. In return, businesses pay wages, rent, and dividends and interest, which households receive as income.

As *consumers,* household members use their income to purchase the goods and services produced by business. Today, approximately 70 percent of our nation's total production consists of **consumer products**—goods and services purchased by individuals for personal consumption.[8] This means that consumers, as a group, are the biggest customers of American business.

Businesses Like households, businesses are engaged in two different exchanges. They exchange money for natural resources, labor, and capital and use these resources to produce goods and services. Then they exchange their goods and services for sales revenue. This sales revenue, in turn, is exchanged for additional resources, which are used to produce and sell more goods and services.

Along the way, of course, business owners would like to remove something from the circular flow in the form of profits. When business profits are distributed to business owners, these profits become household income. (Business owners are, after all, members of households.) Households try to retain some income as savings. But are profits and savings really removed from the flow? Usually not! When the economy is running smoothly, households are willing to invest their savings in businesses. They can do so directly by buying stocks issued by businesses, by purchasing shares in mutual funds that purchase stocks in businesses, or by lending money to businesses. They can also invest indirectly by placing their savings in bank accounts. Banks and other financial institutions then invest these savings as part of their normal business operations. Thus, business profits, too, are retained in the business system, and the circular flow in Figure 1.5 is complete. How, then, does government fit in?

Governments The Preamble to the Constitution sets forth the responsibility of the government to protect and promote public welfare. The numerous government services are important but they (1) would either not be produced by private business firms or (2) would be produced only for those who could afford them. Typical services include national defense, police, fire protection, education, and construction of roads and highways. To pay for all these services, governments collect a variety of taxes from households (such as personal income taxes and sales taxes) and from businesses (corporate income taxes).

Figure 1.5 shows this exchange of taxes for government services. It also shows government spending of tax dollars for resources and products required to provide these services.

Actually, with government included, our circular flow looks more like a combination of several flows. In reality, it is. The important point is that together the various flows make up a single unit—a complete economic system that effectively provides answers to the basic economic questions. Simply put, the system works.

Command Economies

Before we discuss how to measure a nation's economic performance, we look quickly at another economic system called a command economy. A **command economy** is an economic system in which the government decides *what* goods and services will be produced, *how* they will be produced, *for whom* available goods and services will be produced, and *who* owns and controls the major factors of production. The answers to all four basic economic questions are determined, at least to some degree, through centralized government planning. Today, two types of economic systems—*socialism* and *communism*—serve as examples of command economies.

consumer products goods and services purchased by individuals for personal consumption

command economy an economic system in which the government decides what goods and services will be produced, how they will be produced, for whom available goods and services will be produced, and who owns and controls the major factors of production

Socialism In a socialist economy, the key industries are owned and controlled by the government. Such industries usually include transportation, utilities, communications, banking, and industries producing important materials such as steel. Land, buildings, and raw materials may also be the property of the state in a socialist economy. Depending on the country, private ownership of smaller businesses is permitted to varying degrees. Usually, people may choose their own occupations, although many work in state-owned industries.

What to produce and how to produce it are determined in accordance with national goals, which are based on projected needs and the availability of resources. The distribution of goods and services—who gets what—is also controlled by the state to the extent that it controls taxes, rents, and wages. Among the professed aims of socialist countries are the equitable distribution of income, the elimination of poverty, and the distribution of social services (such as medical care) to all who need them. The disadvantages of socialism include increased taxation and loss of incentive and motivation for both individuals and business owners.

Today, many of the nations that have been labeled as socialist nations traditionally, including France, Sweden, and India, are transitioning to a free-market economy. Currently, many countries that were once thought of as communist countries are now often referred to as socialist countries. Examples of former communist countries often referred to as socialists (or even capitalists) include most of the nations that were formerly part of the Union of Soviet Socialist Republics, China, and Vietnam.

Communism If Adam Smith was the father of capitalism, Karl Marx was the father of communism. In his writings during the mid-19th century, Marx advocated a classless society whose citizens together owned all economic resources. All workers would then contribute to this *communist* society according to their ability and would receive benefits according to their need.

Since the breakup of the Soviet Union and economic reforms in China and most of the Eastern European countries, the best remaining examples of communism are North Korea and Cuba. Today these so-called communist economies seem to practice a strictly controlled kind of socialism. The basic four economic questions are answered through centralized government plans. Emphasis is placed on the production of goods the government needs rather than on the products that consumers might want, so there are frequent shortages of consumer goods. Workers have little choice of jobs, but special skills or talents seem to be rewarded with special privileges.

MEASURING ECONOMIC PERFORMANCE

4 **Identify the ways to measure economic performance.**

Today, it is hard to turn on the radio, watch the news on television, use the Internet, or read the newspaper without hearing or seeing something about the economy. Consider for just a moment the following questions:

- Is the gross domestic product for the United States increasing or decreasing?
- Why is the unemployment rate important?
- Are U.S. workers as productive as workers in other countries?

The information needed to answer these questions, along with the answers to other similar questions, is easily obtainable from many sources. More important, the answers to these and other questions can be used to gauge the economic health of the nation. For individuals, the health of the nation's economy can affect:

- the financing you need to continue your education;
- your ability to get a job; and
- the amount of interest you pay for credit card purchases, automobiles, homes, and other credit transactions.

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One way to reduce costs is to manufacture products in a foreign country. In this photo, a Chinese worker assembles an electronic keyboard. To compete with foreign competition, manufacturers in the United States use sophisticated equipment and the latest technology to reduce costs, increase profits, *and* improve productivity.

The Importance of Productivity in the Global Marketplace

One way to measure a nation's economic performance is to assess its productivity. **Productivity** is the average level of output per worker per hour. An increase in productivity results in economic growth because a larger number of goods and services are produced by a given labor force. To see how productivity affects you and the economy, consider the following three questions:

Question: *How does productivity growth affect the economy?*

Answer: Because of increased productivity, it now takes fewer workers to produce more goods and services. As a result, employers have reduced costs, earned more profits, and sold their products for less. Finally, productivity growth helps American business to compete more effectively with other nations in a competitive world.

Question: *How does a nation improve productivity?*

Answer: Reducing costs and enabling employees to work more efficiently are at the core of all attempts to improve productivity. For example, productivity in the United States is expected to improve dramatically as more economic activity is transferred onto the Internet, reducing costs for customer service and handling routine ordering functions between businesses. Other methods that can be used to increase productivity are discussed in detail in Chapter 8, Producing Quality Goods and Services.

Question: *Is productivity growth always good?*

Answer: Fewer workers producing more goods and services can lead to higher unemployment rates. In this case, increased productivity is good for employers but not good for unemployed workers seeking jobs in a very competitive work environment. Because employers had been able to produce more goods and services with fewer employees during the recent economic crisis, they did not want to increase the firm's salary expense by hiring new employees after the economy began to improve.

The Nation's Gross Domestic Product

In addition to productivity, a measure called *gross domestic product* can be used to measure the economic well-being of a nation. **Gross domestic product (GDP)** is the total dollar value of all goods and services produced by all people within the boundaries of a country during a one-year period. For example, the values of automobiles produced by employees in an American-owned General Motors plant and a Japanese-owned Toyota plant in the United States are both included in the GDP for the United States. The U.S. GDP was $15.1 trillion in 2011.[9] (*Note:* At the time of publication, 2011 was the last year for which complete statistics were available.)

The GDP figure facilitates comparisons between the United States and other countries because it is the standard used in international guidelines for economic accounting. It is also possible to compare the GDP for one nation over several different time periods. This comparison allows observers to determine the extent to which a nation is experiencing economic growth. For example, government experts project that GDP will grow to $21.8 trillion by the year 2018.[10]

To make accurate comparisons of the GDP for different years, we must adjust the dollar amounts for inflation. **Inflation** is a general rise in the level of prices. (The opposite of inflation is deflation.) **Deflation** is a general decrease in the level of prices. By using inflation-adjusted figures, we are able to measure the *real* GDP for a nation. In effect, it is now possible to compare the products and services produced by a nation in constant dollars—dollars that will purchase the same amount of goods and services. Figure 1.6 depicts the GDP of the United States in current dollars and the real GDP in

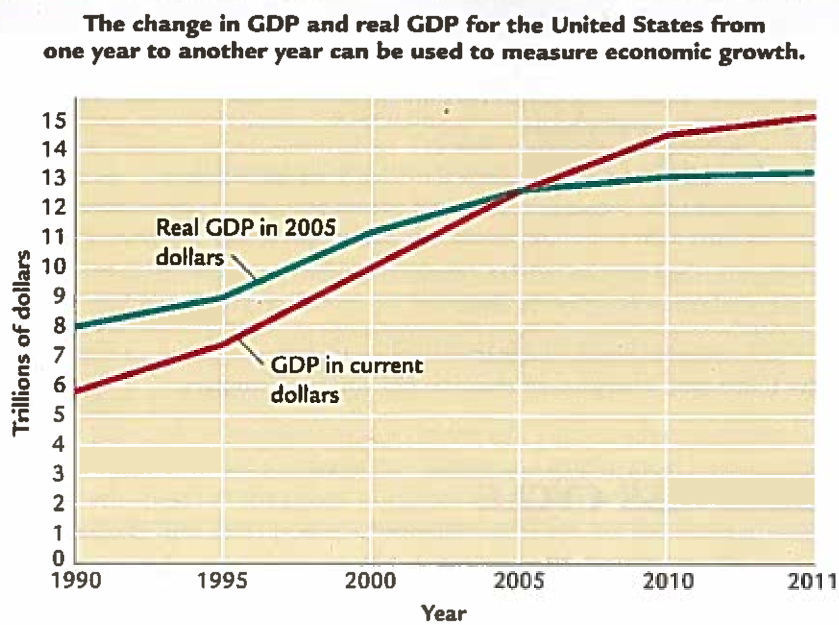
productivity the average level of output per worker per hour

gross domestic product (GDP) the total dollar value of all goods and services produced by all people within the boundaries of a country during a one-year period

inflation a general rise in the level of prices

deflation a general decrease in the level of prices

FIGURE 1.6 GDP in Current Dollars and in Inflation-Adjusted Dollars



Source: U.S. Bureau of Economic Analysis Web site at www.bea.gov (accessed January 30, 2012).

inflation-adjusted dollars. Note that between 1990 and 2011, America's real GDP grew from $8 trillion to $13.3 trillion.[11]

Important Economic Indicators that Measure a Nation's Economy

In addition to productivity, GDP, and real GDP, other economic measures exist that can be used to evaluate a nation's economy. Because of the recent economic crisis, one very important statistic that is in the news on a regular basis is the unemployment rate. The **unemployment rate** is the percentage of a nation's labor force unemployed at any time. According to the Bureau of Labor Statistics, when workers are unemployed, they, their families, and the country as a whole lose. Workers and their families lose wages, and the country loses the goods or services that could have been produced. In addition, the purchasing power of these workers is lost, which can lead to unemployment for yet other workers.[12] Although the unemployment rate for the United States is typically about 4 to 6 percent, it peaked during the recent economic crisis. Despite both federal and state programs to reduce the unemployment rate for the United States, it is still hovering around 8 percent at the time of publication. This is an especially important statistic—especially if you are unemployed.

The **consumer price index (CPI)** is a monthly index that measures the changes in prices of a fixed basket of goods purchased by a typical consumer in an urban area. Goods listed in the CPI include food and beverages, transportation, housing, clothing, medical care, recreation, education, communication, and other goods and services. Economists often use the CPI to determine the effect of inflation on not only the nation's economy but also individual consumers. Another monthly index is the producer price index. The **producer price index (PPI)** measures prices that producers receive for their finished goods. Because changes in the PPI reflect price increases or decreases at the wholesale level, the PPI is an accurate predictor of both changes in the CPI and prices that consumers will pay for many everyday necessities.

Some additional economic measures are described in Table 1.2. Like the measures for GDP, real GDP, unemployment rate, and price indexes, these measures can be used to compare one economic statistic over different periods of time.

unemployment rate the percentage of a nation's labor force unemployed at any time

consumer price index (CPI) a monthly index that measures the changes in prices of a fixed basket of goods purchased by a typical consumer in an urban area

producer price index (PPI) an index that measures prices that producers receive for their finished goods

TABLE 1.2 Common Measures Used to Evaluate a Nation's Economic Health

Economic Measure	Description
1. Balance of trade	The total value of a nation's exports minus the total value of its imports over a specific period of time.
2. Consumer confidence index	A measure of how optimistic or pessimistic consumers are about the nation's economy. This measure is usually reported on a monthly basis.
3. Corporate profits	The total amount of profits made by corporations over selected time periods.
4. Inflation rate	An economic statistic that tracks the increase in prices of goods and services over a period of time. This measure is usually calculated on a monthly or an annual basis.
5. National income	The total income earned by various segments of the population, including employees, self-employed individuals, corporations, and other types of income.
6. New housing starts	The total number of new homes started during a specific time period.
7. Prime interest rate	The lowest interest rate that banks charge their most credit-worthy customers.

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Examine the different phases in the typical business cycle. **5**

THE BUSINESS CYCLE

All industrialized nations of the world seek economic growth, full employment, and price stability. However, a nation's economy fluctuates rather than grows at a steady pace every year. In fact, if you were to graph the economic growth rate for a country like the United States, it would resemble a roller coaster ride with peaks (high points) and troughs (low points). These fluctuations are generally referred to as the **business cycle**, that is, the recurrence of periods of growth and recession in a nation's economic activity. At the time of publication, many experts believed that the U.S. economy was showing signs of improvement. However, the recent economic crisis that began in fall 2007 caused a recession that will require more time before the nation experiences a complete recovery. The nation's unemployment rate is still high. People are reluctant to spend money on many consumer goods. Stock prices, although improving, are still below the record values experienced a few years ago. Although the federal government has enacted a number of stimulus plans designed to help unemployed workers, to shore up the nation's banks and Wall Street firms, to reduce the number of home foreclosures, and to free up credit for both individuals and businesses, many experts still believe that we have serious financial problems. For one, the size of the national debt—a topic described later in this section—is a concern. Another problem—the inequality of income and wealth—has also become evident as a result of the Occupy Wall Street protestors and similar groups of discontented people. To make matters worse, the recent economic crisis did not affect just the U.S. economy but also the economies of countries around the world.

business cycle the recurrence of periods of growth and recession in a nation's economic activity

recession two or more consecutive three-month periods of decline in a country's GDP

The dreaded pink slip. During the recent economic crisis, unemployment rates were over 10 percent and millions of Americans got a "pink slip" and lost their jobs. While economists still debate if we were in a recession or a depression, the economy is now improving and the unemployment rate is beginning to decline.

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The changes that result from either economic growth or economic downturn affect the amount of products and services that consumers are willing to purchase and, as a result, the amount of products and services produced by business firms. Generally, the business cycle consists of four phases: the peak (sometimes called prosperity), recession, the trough, and recovery (sometimes called expansion).

During the *peak period* (prosperity), the economy is at its highest point and unemployment is low. Total income is relatively high. As long as the economic outlook remains prosperous, consumers are willing to buy products and services. In fact, businesses often expand and offer new products and services during the peak period to take advantage of consumers' increased buying power.

Generally, economists define a **recession** as two or more consecutive three-month periods of decline in a country's GDP. Because unemployment rises during a recession, total buying power declines. The pessimism that accompanies a recession often stifles both consumer and business spending. As buying power decreases, consumers tend to become more value conscious and reluctant to purchase frivolous or nonessential items. And companies and government at all levels often postpone or go slow on major projects during a recession. In response to a recession, many businesses focus on producing the products and services that provide the most value to their customers. And yet, there are still opportunities out there for business firms that are well managed and provide goods and services that their customers need. For example, Caterpillar, a global company that produces earth moving and construction equipment has profited from the ongoing building boom in developing nations, where many basic infrastructure improvements move ahead regardless of what the economic conditions are in the rest of the world.

Economists define a **depression** as a severe recession that lasts longer than a typical recession and has a larger decline in business activity when compared to a recession. A depression is characterized by extremely high unemployment rates, low wages, reduced purchasing power, lack of confidence in the economy, lower stock values, and a general decrease in business activity.

The third phase of the business cycle is the *trough*. The trough of a recession or depression is the turning point when a nation's production and employment bottom out and reach their lowest levels. To offset the effects of recession and depression, the federal government uses both monetary and fiscal policies. **Monetary policies** are the Federal Reserve's decisions that determine the size of the supply of money in the nation and the level of interest rates. Through **fiscal policy,** the government can influence the amount of savings and expenditures by altering the tax structure and changing the levels of government spending.

Although the federal government collects approximately $2 trillion in annual revenues, the government usually spends more than it receives, resulting in a **federal deficit.** For example, the government had a federal deficit for each year between 2002 and 2011. The total of all federal deficits is called the **national debt.** Today, the U.S. national debt is $15.2 trillion or approximately $49,000 for every man, woman, and child in the United States.[13]

Since World War II, business cycles have lasted from three to five years from one peak period to the next peak period. During the same time period, the average length of recessions has been 11 months.[14] Some experts believe that effective use of monetary and fiscal policies can speed up recovery and reduce the amount of time the economy is in recession. *Recovery* (or *expansion*) is the movement of the economy from recession or depression to prosperity. High unemployment rates decline, income increases, and both the ability and the willingness to buy rise.

At the time of publication, many business leaders and politicians were debating whether the U.S. economy is still in recession, in the trough, or beginning recovery. Unfortunately, many of the problems that caused the recent economic crisis are still there, and they will take years to correct and resolve.

depression a severe recession that lasts longer than a typical recession and has a larger decline in business activity when compared to a recession

monetary policies Federal Reserve decisions that determine the size of the supply of money in the nation and the level of interest rates

TYPES OF COMPETITION

6 Outline the four types of competition.

Our capitalist system ensures that individuals and businesses make the decisions about what to produce, how to produce it, and what price to charge for the product. Mattel, Inc., for example, can introduce new versions of its famous Barbie doll, license the Barbie name, change the doll's price and method of distribution, and attempt to produce and market Barbie in other countries or over the Internet at www.mattel.com. Our system also allows customers the right to choose between Mattel's products and those produced by competitors.

As a consumer, you get to choose which products or services you want to buy. Competition like that between Mattel and other toy manufacturers is a necessary and extremely important by-product of capitalism. Business **competition** is essentially a rivalry among businesses for sales to potential customers. In a capitalistic economy, competition also ensures that a firm will survive only if it serves its customers well by providing products and services that meet needs. Economists recognize four different degrees of competition ranging from ideal, complete competition to no competition at all. These are perfect competition, monopolistic competition, oligopoly, and

fiscal policy government influence on the amount of savings and expenditures; accomplished by altering the tax structure and by changing the levels of government spending

federal deficit a shortfall created when the federal government spends more in a fiscal year than it receives

national debt the total of all federal deficits

competition rivalry among businesses for sales to potential customers

© SUSAN VAN ETTEN

Competition often gives consumers a choice. Often wonder why there are so many soap products? It's called competition. Different manufacturers use product differentiation to develop and promote the differences between their products and all similar products. Not only does product differentiation help their products stand out from the competition, it gives you—the consumer—a choice.

monopoly. For a quick overview of the different types of competition, including numbers of firms and examples for each type, look at Table 1.3.

Perfect Competition

Perfect (or pure) competition is the market situation in which there are many buyers and sellers of a product, and no single buyer or seller is powerful enough to affect the price of that product. For perfect competition to exist, there are five very important concepts.

- We are discussing the market for a single product, such as bushels of wheat.
- There are no restrictions on firms entering the industry.
- All sellers offer essentially the same product for sale.
- All buyers and sellers know everything there is to know about the market (including, in our example, the prices that all sellers are asking for their wheat).
- The overall market is not affected by the actions of any one buyer or seller.

When perfect competition exists, every seller should ask the same price that every other seller is asking. Why? Because if one seller wanted 50 cents more per bushel of wheat than all the others, that seller would not be able to sell a single bushel. Buyers could—and would—do better by purchasing wheat from the competition. On the other hand, a firm willing to sell below the going price would sell all its wheat quickly. However, that seller would lose sales revenue (and profit) because buyers are actually willing to pay more.

In perfect competition, then, sellers—and buyers as well—must accept the going price. The price of each product is determined by the actions of all buyers and all sellers together through the forces of supply and demand.

The Basics of Supply and Demand The **supply** of a particular product is the quantity of the product that producers are willing to sell at each of various prices. Producers are rational people, so we would expect them to offer more of a product for sale at higher prices and to offer less of the product at lower prices, as illustrated by the supply curve in Figure 1.7.

The **demand** for a particular product is the quantity that buyers are willing to purchase at each of various prices. Buyers, too, are usually rational, so we would expect them—as a group—to buy more of a product when its price is low and to buy less of the product when its price is high, as depicted by the demand curve in Figure 1.7.

The Equilibrium, or Market, Price There is always one certain price at which the demand for a product is exactly equal to the quantity of that product produced. Suppose that producers are willing to *supply* two million bushels of wheat at a price of $7 per bushel and that buyers are willing to *purchase* two million bushels at a price of $7 per bushel.

perfect (or pure) competition the market situation in which there are many buyers and sellers of a product, and no single buyer or seller is powerful enough to affect the price of that product

supply the quantity of a product that producers are willing to sell at each of various prices

demand the quantity of a product that buyers are willing to purchase at each of various prices

TABLE 1.3 Four Different Types of Competition

The number of firms determines the degree of competition within an industry.

Type of Competition	Number of Business Firms or Suppliers	Real-World Examples
1. Perfect	Many	Corn, wheat, peanuts
2. Monopolistic	Many	Clothing, shoes
3. Oligopoly	Few	Automobiles, cereals
4. Monopoly	One	Software protected by copyright, many local public utilities

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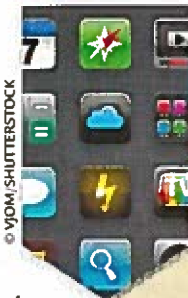
In other words, supply and demand are in balance, or in equilibrium, at the price of $7. Economists call this price the *market price*. The **market price** of any product is the price at which the quantity demanded is exactly equal to the quantity supplied.

In theory and in the real world, market prices are affected by anything that affects supply and demand. The *demand* for wheat, for example, might change if researchers suddenly discovered that it offered a previously unknown health benefit. Then buyers would demand more wheat at every price. Or the *supply* of wheat might change if new technology permitted the production of greater quantities of wheat from the same amount of acreage. Other changes that can affect competitive prices are shifts in buyer tastes, the development of new products, fluctuations in income owing to inflation or recession, or even changes in the weather that affect the production of wheat.

Perfect competition is quite rare in today's world. Many real markets, however, are examples of monopolistic competition.



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Personal APPS

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Why do consumers choose one product instead of another? The next time you go to the discount store, supermarket, or drug store, notice all the products competing for your dollars. No two canned vegetables, shampoos, or candies are exactly alike. Thanks to product differentiation, you have a lot of choices when you shop.

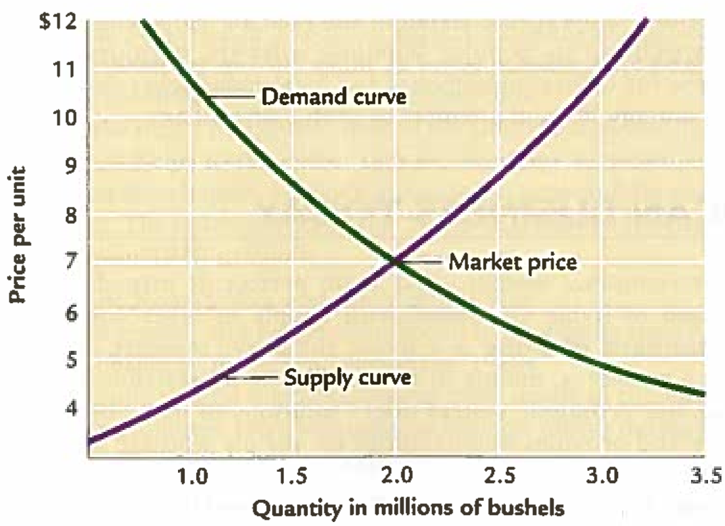
Monopolistic Competition

Monopolistic competition is a market situation in which there are many buyers along with a relatively large number of sellers. The various products available in a monopolistically competitive market are very similar in nature, and they are all intended to satisfy the same need. However, each seller attempts to make its product different from the others by providing unique product features, an attention-getting brand name, unique packaging, or services such as free delivery or a lifetime warranty.

Product differentiation is the process of developing and promoting differences between one's products and all competitive products. It is a fact of life for the producers of many consumer goods, from soaps to clothing to furniture to shoes. A furniture manufacturer such as Thomasville sees what looks like a mob of competitors, all trying to chip away at its share of the market. By differentiating each of its products from all

FIGURE 1.7 Supply Curve and Demand Curve

The intersection of a supply curve and a demand curve is called the *equilibrium*, or *market price*. This intersection indicates a single price and quantity at which suppliers will sell products and buyers will purchase them.



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market price the price at which the quantity demanded is exactly equal to the quantity supplied

monopolistic competition a market situation in which there are many buyers along with a relatively large number of sellers who differentiate their products from the products of competitors

product differentiation the process of developing and promoting differences between one's products and all competitive products similar products produced by competitors, Thomasville obtains some limited control over the market price of its product.

Oligopoly

An **oligopoly** is a market (or industry) situation in which there are few sellers. Generally, these sellers are quite large, and sizable investments are required to enter into their market. Examples of oligopolies are the automobile, airline, car rental, cereal, and farm implement industries.

Because there are few sellers in an oligopoly, the market actions of each seller can have a strong effect on competitors' sales and prices. If General Motors, for example, reduces its automobile prices, Ford, Honda, Toyota, and Nissan usually do the same to retain their market shares. In the absence of much price competition, product differentiation becomes the major competitive weapon; this is very evident in the advertising of the major automobile manufacturers. For instance, when Toyota was faced with declining sales as a result of quality and safety issues, it began offering buyer incentives to attract new-car buyers. Quickly, both Ford and General Motors began offering similar incentives and for the same reason—to attract new-car buyers.

Monopoly

A **monopoly** is a market (or industry) with only one seller, and there are barriers to keep other firms from entering the industry. In a monopoly, there is no close substitute for the product or service. Because only one firm is the supplier of a product, it would seem that it has complete control over price. However, no firm can set its price at some astronomical figure just because there is no competition; the firm would soon find that it has no customers or sales revenue either. Instead, the firm in a monopoly position must consider the demand for its product and set the price at the most profitable level.

Classic examples of monopolies in the United States are public utilities, including companies that provide local gas, water, or electricity. Each utility firm operates in a **natural monopoly,** an industry that requires a huge investment in capital and within which any duplication of facilities would be wasteful. Natural monopolies are permitted to exist because the public interest is best served by their existence, but they operate under the scrutiny and control of various state and federal agencies. Although many public utilities are still classified as natural monopolies, there is increased competition in many areas of the country. For example, there have been increased demands for consumer choice when selecting a company that provides electrical service to both homes and businesses.

A legal monopoly—sometimes referred to as a *limited monopoly*—is created when a government entity issues a franchise, license, copyright, patent, or trademark. For example, a copyright exists for a specific period of time and can be used to protect the owners of written materials from unauthorized use by competitors that have not shared in the time, effort, and expense required for their development. Because Microsoft owns the copyright on its popular Windows software, it enjoys a legal-monopoly position. Except for natural monopolies and legal monopolies, federal antitrust laws prohibit both monopolies and attempts to form monopolies.

oligopoly a market (or industry) in which there are few sellers

monopoly a market (or industry) with only one seller, and there are barriers to keep other firms from entering the industry

natural monopoly an industry requiring huge investments in capital and within which any duplication of facilities would be wasteful and thus not in the public interest

AMERICAN BUSINESS TODAY

7 Summarize the factors that affect the business environment and the challenges that American businesses will encounter in the future.

Although our economic system is far from perfect, it provides Americans with a high standard of living compared with people in other countries throughout the world. **Standard of living** is a loose, subjective measure of how well off an individual or a society is, mainly in terms of want satisfaction through goods and services. Also, our economic system offers solutions to many of the problems that plague society and provides opportunities for people who are willing to work and to continue learning.

To understand the current business environment and the challenges ahead, it helps to understand how business developed.

standard of living a loose, subjective measure of how well off an individual or a society is, mainly in terms of want satisfaction through goods and services

Early Business Development

Our American business system has its roots in the knowledge, skills, and values that the earliest settlers brought to this country. The first settlers in the United States were concerned mainly with providing themselves with basic necessities—food, clothing, and shelter. Almost all families lived on farms, and the entire family worked at the business of surviving. They used their surplus for trading, mainly by barter, among themselves and with the English trading ships that called at the colonies. **Barter** is a system of exchange in which goods or services are traded directly for other goods or services without using money. As this trade increased, small businesses began to appear. Some settlers were able to use their skills and their excess time to work under the domestic system of production. The **domestic system** was a method of manufacturing in which an entrepreneur distributed raw materials to various homes, where families would process them into finished goods. The merchant entrepreneur then offered the goods for sale.

© AP PHOTO

Gas shortages—could it happen again?
For an industrialized economy like the United States, crude oil is an essential natural resource. When the nation experienced a shortage of crude oil during the mid-1970s, it was common to see signs like the one in this photo. Even now, both the supply and price for a gallon of gasoline are still concerns as the nation begins to rebound from the recent economic crisis.

Then, in 1793, a young English apprentice mechanic named Samuel Slater set up a textile factory in Pawtucket, Rhode Island, to spin raw cotton into thread. Slater's ingenuity resulted in America's first use of the **factory system** of manufacturing, in which all the materials, machinery, and workers required to manufacture a product are assembled in one place. The Industrial Revolution in America was born. A manufacturing technique called *specialization* was used to improve productivity. **Specialization** is the separation of a manufacturing process into distinct tasks and the assignment of the different tasks to different individuals.

The years from 1820 to 1900 were the golden age of invention and innovation in machinery. At the same time, new means of transportation greatly expanded the domestic markets for American products. Certainly, many basic characteristics of our modern business system took form during this time period.

Business Development in the 1900s

Industrial growth and prosperity continued well into the 20th century. Henry Ford's moving automotive assembly line, which brought the work to the worker, refined the concept of specialization and helped spur on the mass production of consumer goods. Fundamental changes occurred in business ownership and management as well. No longer were the largest businesses owned by one individual; instead, ownership was in the hands of thousands of corporate shareholders who were willing to invest in—but not to operate—a business.

The Roaring Twenties ended with the sudden crash of the stock market in 1929 and the near collapse of the economy. The Great Depression that followed in the 1930s was a time of misery and human suffering. People lost their faith in business and its ability to satisfy the needs of society without government involvement. After Franklin D. Roosevelt became president in 1933, the federal government devised a number of programs to get the economy moving again. In implementing these programs, the government got deeply involved in business for the first time.

To understand the major events that shaped the United States during the remainder of the 20th century, it helps to remember that the economy was compared to a roller coaster ride earlier in this chapter—periods of economic growth followed by periods of economic slowdown. The following are major events that shaped the nation's economy during the period from 1940 to 2000:

- World War II, the Korean War, and the Vietnam War
- Rapid economic growth and higher standard of living during the 1950s and 1960s
- The social responsibility movement during the 1960s
- A shortage of crude oil and higher prices for most goods in the mid-1970s
- High inflation, high interest rates, and reduced business profits during the early 1980s
- Sustained economic growth in the 1990s

During the last part of the 20th century, the Internet became a major force in the economy. e-Business—a topic we will continue to explore throughout this text—became

barter a system of exchange in which goods or services are traded directly for other goods or services without using money

domestic system a method of manufacturing in which an entrepreneur distributes raw materials to various homes, where families process them into finished goods to be offered for sale by the merchant entrepreneur

factory system a system of manufacturing in which all the materials, machinery, and workers required to manufacture a product are assembled in one place

specialization the separation of a manufacturing process into distinct tasks and the assignment of the different tasks to different individuals an accepted method of conducting business. **e-Business** is the organized effort of individuals to produce and sell *through the Internet,* for a profit, the products and services that satisfy society's needs.

Unfortunately, by the last part of the 20th century, a larger number of business failures and declining stock values were initial signs that larger economic problems were on the way.

A New Century: 2000 and Beyond

According to many economic experts, the first part of the 21st century might be characterized as the best of times and the worst of times rolled into one package. On the plus side, technology became available at an affordable price. Both individuals and businesses could now access information with the click of a button. They also could buy and sell merchandise online.

In addition to information technology, the growth of service businesses also changed the way American firms do business in the 21st century. Because service businesses employ approximately 85 percent of the nation's workforce, we now have a service economy.[15] A **service economy** is an economy in which more effort is devoted to the production of services than to the production of goods. Typical service businesses include restaurants, laundries and dry cleaners, real estate, movie theaters, repair companies, and other services that we often take for granted. More information about how service businesses affect the economy is provided in Chapter 8, Producing Quality Goods and Services.

On the negative side, it is hard to watch television, surf the Web, listen to the radio, or read the newspaper without hearing some news about the economy. Because many of the economic indicators described in Table 1.2 on page 20 indicate troubling economic problems, there is still a certain amount of pessimism surrounding the economy.

The Current Business Environment

Before reading on, answer the following question:

> *In today's competitive business world, which of the following environments affects business?*

a. The competitive environment
b. The global environment
c. The technological environment
d. The economic environment
e. All of the above

Correct Answer: e. All the environments listed affect business today.

The Competitive Environment Businesses operate in a competitive environment. As noted earlier in this chapter, competition is a basic component of capitalism. Every day, business owners must figure out what makes their businesses successful and how the goods and services they provide are different from the competition. Often, the answer is contained in the basic definition of business provided on page 10. Just for a moment, review the definition:

> *Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs.*

In the definition of business, note the phrase *satisfy society's needs.* These three words say a lot about how well a successful firm competes with competitors. If you meet customer needs, then you have a better chance at success.

The Global Environment Related to the competitive environment is the global environment. Not only do American businesses have to compete with other American businesses, but they also must compete with businesses from all over the globe. According to global experts, China is one of the fastest-growing economies in the world. And China is not alone. Other countries around the world also compete with U.S. firms. There was once

e-business the organized effort of individuals to produce and sell *through the Internet*, for a profit, the products and services that satisfy society's needs

service economy an economy in which more effort is devoted to the production of services than to the production of goods a time when the label "Made in the United States" gave U.S. businesses an inside edge both at home and in the global marketplace. Now, other countries manufacture and sell goods. According to Richard Haass, president of the Council on Foreign Relations, "There will be winners and losers from globalization. We win every time we go shopping because prices are lower. Choice is greater because of globalization. But there are losers. There are people who will lose their jobs either to foreign competition or [to] technological innovation."[16]

While many foreign firms are attempting to sell goods and services to U.S. customers, U.S. firms are also increasing both sales and profits by selling goods and services to customers in other countries. In fact there are many "potential" customers in developing nations that will buy goods and services manufactured by U.S. firms. For example, Procter & Gamble sells laundry detergent, soap, and diapers in Nigeria and has plans to do business in more than 50 African countries.[17] And Procter & Gamble is not alone. Unilever, DuPont, Johnson & Johnson, General Motors, and many more U.S. companies are also selling goods and services to customers in countries all over the globe. The world is, in fact, a much smaller place than many U.S. business leaders once thought.

The Technology Environment Although increased global competition and technological innovation has changed the way we do business, the technology environment for U.S. businesses has never been more challenging. Changes in manufacturing equipment, distribution of products, and communication with customers are all examples of how technology has changed everyday business practices. For example, many businesses are now using social media to provide customers with information about products and services. If you ask different people, you will often find different definitions for social media, but for our purposes **social media** is defined as online interaction that allows people and businesses to communicate and share ideas, personal information, and information about products or services. To illustrate how popular social media is, consider that Facebook with 800 million current users was launched in 2004 and Twitter with 300 million current users was launched in 2006. Because of rapid developments in social media and the increased importance of technology and information, businesses will need to spend additional money to keep abreast of an ever-changing technology environment and even more money to train employees to use the new technology.

The Economic Environment The economic environment must always be considered when making business decisions. This fact is especially important when the nation's economy takes a nosedive or an individual firm's sales revenue and profits are declining. For example, both small and large business firms reduced both spending and hiring new employees over the last four years because of the recent economic crisis.

In addition to economic pressures, today's socially responsible managers and business owners must be concerned about the concept of sustainability. According to the U.S. Environmental Protection Agency, **sustainability** means meeting the needs of the present without compromising the ability of future generations to meet their own needs.[18] Although the word *green* used to mean a color in a box of crayons, today green means a new way of doing business. As a result, a combination of forces, including economic factors, growth in population, increased energy use, and concerns for the environment, is changing the way individuals live and businesses operate.

When you look back at the original question we asked at the beginning of this section, clearly, each different type of environment—competitive, global, technological, and economic—affects the way a business does *business*. As a result, there are always opportunities for improvement and challenges that must be considered.

The Challenges Ahead

There it is—the American business system in brief.

When it works well, it provides jobs for those who are willing to work, a standard of living that few countries can match, and many opportunities for personal advancement. However, like every other system devised by humans, it is not perfect. Our business system may give us prosperity, but it also gave us the Great Depression of the

social media the online interaction that allows people and businesses to communicate and share ideas, personal information, and information about products or services

sustainability meeting the needs of the present without compromising the ability of future generations to meet their own needs

1930s, the economic problems of the 1970s and the early 1980s, and the economic crisis that began in the fall of 2007.

Obviously, the system can be improved. Certainly, there are plenty of people who are willing to tell us exactly what they think the American economy needs. However, these people often provide us only with conflicting opinions. Who is right and who is wrong? Even the experts cannot agree.

The experts do agree, however, that several key issues will challenge our economic system (and our nation) over the next decade. Some of the questions to be resolved include:

- How can we create a more stable economy and create new jobs for the unemployed?
- How can we regulate banks, savings and loan associations, credit unions, and other financial institutions to prevent the type of abuses that led to the recent economic crisis?
- How do we reduce the national debt and still maintain a healthy economy and stimulate business growth?
- How can we use technology to make American workers more productive and American firms more competitive in the global marketplace?
- How can we preserve the benefits of competition and small business in our American economic system?
- How can we encourage economic growth and at the same time continue to conserve natural resources and sustain our environment?
- How can we meet the needs of two-income families, single parents, older Americans, and the less fortunate who need health care and social programs to exist?
- How can we defeat terrorism and resolve conflict with Iran, North Korea, and other countries throughout the world?

The answers to these questions are anything but simple. In the past, Americans have always been able to solve their economic problems through ingenuity and creativity. Now, as we continue the journey through the 21st century, we need that same ingenuity and creativity not only to solve our current problems but also to compete in the global marketplace and build a nation and economy for future generations.

The American business system is not perfect by any means, but it does work reasonably well. We discuss some of its problems in Chapter 2 as we examine the topics of social responsibility and business ethics.

return to Inside BUSINESS

Zynga

Online games have become big business. In just a few years—and during a difficult economic period—founder Mark Pincus has transformed Zynga from a start-up game company into a profitable, 3,000-employee corporation with shares traded on the Nasdaq stock exchange. Social media games are about more than winning and losing: "We're giving a reliable 15 minutes a day that lets them not only play but also connect with people in their lives with some level of meaning," Pincus explains.

Competing against established rival firms such as Electronic Arts and Activision Blizzard, Zynga must continually introduce new games to retain player loyalty and keep revenues growing through the sale of virtual goods and advertising. Pincus and his management team keep a close eye on Zynga's business health by measuring how many people play each game, how many buy virtual goods, and which game features are the most popular. Can Zynga keep clicking ahead?

Questions

1. Of the four resources (material, human, informational, and financial) that businesses combine and organize to be successful, which have had the most significant effect on Zynga's growth—and why?
2. Of the four environments that affect business (competitive, global, technological, and economic), which do you think will help and hurt Zynga's long-term profitability?

SUMMARY

Looking for Success?
Get Flashcards, Quizzes, Games, Crosswords, and more @ www.cengagebrain.com.

1 Discuss what you must do to be successful in the world of business.

For many years, people in business—both employees and managers—assumed that prosperity would continue. When faced with both economic problems and increased competition, a large number of these people began to ask the question: What do we do now? Although this is a fair question, it is difficult to answer. Certainly, for a college student taking business courses or an employee just starting a career, the question is even more difficult to answer. And yet there are still opportunities out there for people who are willing to work hard, continue to learn, and possess the ability to adapt to change. The kind of career you choose ultimately will depend on your own values and what you feel is most important in life. By studying business, you can become a better employee or manager or you may decide to start your own business. You can also become a better consumer and investor.

2 Define *business* and identify potential risks and rewards.

Business is the organized effort of individuals to produce and sell, for a profit, the goods and services that satisfy society's needs. Four kinds of resources—material, human, financial, and informational—must be combined to start and operate a business. The three general types of businesses are service businesses, manufacturers, and marketing intermediaries. Profit is what remains after all business expenses are deducted from sales revenue. It is the payment that owners receive for assuming the risks of business—primarily the risks of not receiving payment and of losing whatever has been invested in the firm. Although many people believe that profit is literally the bottom line or most important goal for a business, many corporations are careful to point out their efforts to sustain the planet, participate in the green ecological movement, and help people to live better lives.

3 Define *economics* and describe the two types of economic systems: capitalism and command economy.

Economics is the study of how wealth is created and distributed. An economic system must answer four questions: *What* goods and services will be produced? *How* will they be produced? *For whom* will they be produced? *Who* owns and who controls the major factors of production? Capitalism (on which our economic system is based) is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Capitalism stems from the theories of Adam Smith. Smith's pure laissez-faire capitalism is an economic system in which the factors of production are owned by private entities and all individuals are free to use their resources as they see fit; prices are determined by the workings of supply and demand in competitive markets; and the economic role of government is limited to rule maker and umpire.

Our economic system today is a mixed economy. In the circular flow that characterizes our business system (see Figure 1.5), households and businesses exchange resources for goods and services, using money as the medium of exchange. In a similar manner, the government collects taxes from businesses and households and purchases products and resources with which to provide services.

In a command economy, government, rather than individuals, owns many of the factors of production and provides the answers to the three other economic questions. Socialist and communist economies are—at least in theory—command economies.

4 Identify the ways to measure economic performance.

One way to evaluate the performance of an economic system is to assess changes in productivity, which is the average level of output per worker per hour. Gross domestic product (GDP) can also be used to measure a nation's economic well-being and is the total dollar value of all goods and services produced by all people within the boundaries of a country during a one-year period. It is also possible to adjust GDP for inflation and thus to measure real GDP. In addition to GDP, other economic indicators include a nation's balance of trade, consumer confidence index, consumer price index (CPI), corporate profits, inflation rate, national income, new housing starts, prime interest rate, producer price index (PPI), and unemployment rate.

5 Examine the different phases in the typical business cycle.

A nation's economy fluctuates rather than grows at a steady pace every year. These fluctuations are generally referred to as the business cycle. Generally, the business cycle consists of four states: the peak (sometimes called prosperity), recession, the trough, and recovery (sometimes called expansion). Some experts believe that effective use of monetary policy (the Federal Reserve's decisions that determine the size of the supply of money and the level of interest rates) and fiscal policy (the government's influence on the amount of savings and expenditures) can speed up recovery.

A federal deficit occurs when the government spends more than it receives in taxes and other revenues. At the time of publication, the national debt is over $15 trillion or approximately $49,000 for every man, woman, and child in the United States.

6 Outline the four types of competition.

Competition is essentially a rivalry among businesses for sales to potential customers. In a capitalist economy, competition works to ensure the efficient and effective operation of business. Competition also ensures that a firm will survive only if it serves its customers well by providing products and services that meet their needs. Economists recognize four degrees of competition. Ranging from most to least competitive, the four degrees are perfect competition, monopolistic competition, oligopoly, and monopoly. The factors of supply and demand generally influence the price that customers pay producers for goods and services.

7 Summarize the factors that affect the business environment and the challenges that American businesses will encounter in the future.

From the beginning of the Industrial Revolution to the phenomenal expansion of American industry in the 19th and early 20th centuries, our government maintained an essentially laissez-faire attitude toward business. However, during the Great Depression of the 1930s, the federal government began to provide a number of social services to its citizens.

To understand the major events that shaped the United States during the remainder of the 20th and 21st century, it helps to remember that the economy was compared to a roller coaster ride earlier in this chapter—periods of economic growth followed by periods of economic slowdown. Events and a changing business environment including wars, rapid economic growth, the social responsibility movement, a shortage of crude oil, high inflation, high interest rates, reduced business profits, increased use of technology, e-business, and social media all have shaped business and the economy.

Now more than ever before, the way a business operates is affected by the competitive environment, global environment, technological environment, and economic environment. As a result, business has a number of opportunities for improvement and challenges for the future.

KEY TERMS

You should now be able to define and give an example relevant to each of the following terms:

free enterprise (4)
cultural (or workplace) diversity (6)
business (10)
profit (11)
stakeholders (12)
economics (13)
microeconomics (13)
macroeconomics (13)
economy (13)
factors of production (13)
entrepreneur (14)
capitalism (14)
invisible hand (14)
market economy (15)
mixed economy (15)
consumer products (16)
command economy (16)
productivity (18)
gross domestic product (GDP) (18)
inflation (18)
deflation (18)
unemployment rate (19)
consumer price index (CPI) (19)
producer price index (PPI) (19)
business cycle (20)
recession (20)
depression (21)
monetary policies (21)
fiscal policy (21)
federal deficit (21)
national debt (21)
competition (21)
perfect (or pure) competition (22)
supply (22)
demand (22)
market price (23)
monopolistic competition (23)
product differentiation (23)
oligopoly (24)
monopoly (24)
natural monopoly (24)
standard of living (24)
barter (25)
domestic system (25)
factory system (25)
specialization (25)
e-business (26)
service economy (26)
social media (27)
sustainability (27)

REVIEW QUESTIONS

1. What reasons would you give if you were advising someone to study business?
2. What factors affect a person's choice of careers?
3. Describe the four resources that must be combined to organize and operate a business. How do they differ from the economist's factors of production?
4. Describe the relationship among profit, business risk, and the satisfaction of customers' needs.
5. What are the four basic economic questions? How are they answered in a capitalist economy?
6. Describe the four basic assumptions required for a laissez-faire capitalist economy.
7. Based on Figure 1.5, outline the economic interactions between business and households in our business system.
8. How does capitalism differ from socialism and communism?
9. How is productivity related to the unemployment rate?
10. Define gross domestic product. Why is this economic measure significant?
11. How is the producer price index related to the consumer price index?
12. What are the four phases in a typical business cycle? How are monetary and fiscal policies related to the business cycle?
13. Identify and compare the four forms of competition.
14. Explain how the equilibrium, or market, price of a product is determined.
15. Four different environments that affect business were described in this chapter. Choose one of the environments and explain how it affects a small electronics manufacturer located in Oregon. Why?

DISCUSSION QUESTIONS

1. In what ways have the problems caused by the recent economic crisis affected business firms? In what ways have these problems affected employees and individuals?
2. What factors caused American business to develop into a mixed economic system rather than some other type of economic system?
3. Does an individual consumer really have a voice in answering the basic four economic questions?
4. Is gross domestic product a reliable indicator of a nation's economic health? What might be a better indicator?
5. Discuss this statement: "Business competition encourages efficiency of production and leads to improved product quality."
6. Is government participation in our business system good or bad? What factors can be used to explain your position.
7. Choose one of the challenges listed on page 28 and describe possible ways in which business and society could help to solve or eliminate the problem in the future.

Video Case 1.1

Entertainment Means Profits for Nederlander Concerts

Nederlander Concerts is based in Los Angeles, one of the two biggest markets in the U.S. concert industry (New York is the other). The company, which is one of the few remaining family-owned businesses in the entertainment industry, specializes in booking and promoting musical artists like the Goo Goo Dolls, Maroon 5, and Cyndi Lauper for events in the western United States. It owns or operates some of the theaters, amphitheaters, and arenas—including the Greek Theatre in Los Angeles, the Santa Barbara Bowl, and the Grove in Anaheim—and it rents space for concerts and events in other cities along the West Coast. Nederlander Concerts also partners with some of California's major cities such as Santa Monica and San Jose to manage or operate their civic theaters and present events there.

Since Nederlander Concerts deliberately focuses on small- to mid-sized events, it can offer a unique concert experience that brings audiences and performers closer together. It can therefore sell a high-quality experience at a higher price than seats in a bigger theater yield. Because of this high-quality experience, it can also count on selling out the house, which helps the company and the artists to profit. According to the concert company's chief operating officer, "The key areas or departments of the company include talent-buying and marketing, operations, finance, and business development. . . . I have a talent-buying team, I have a marketing team, we have a general manager of the building, we have a substantial team of people who take care of the fans, take care of the artist, and look after the shows that we buy. We're in a competitive market, and it's pretty interesting what we do."

Although it might seem odd that the concert business is a competitive one, in fact Nederlander Concerts competes with other promoters (like Live Nation) not just for audiences at its events but for bookings by popular artists. Therefore, it must keep both music lovers and performers happy. Musicians are especially concerned with the financial deal they are getting. As Nederlander's chief operating officer explains, "It's not always easy to get the show; there is competition. . . . We have a great reputation with the artist. But also there's one other factor, and that's making the deal. That's making your best offer. That's trying to think about whether the agent is . . . telling you that your competition is paying more, willing to go more. You have to get your own 'I won't go above' number and stop bidding (for the act), or you have to say, 'Okay, I'll pay a little bit more and try to get the show.' So there's a real gamesmanship between agent and buyer. . . . The art of the deal is something we live with every day."

Given the talent, how does Nederlander get music lovers to its events? Says its vice president of marketing, "It's learning about the market, and picking up every newspaper you can find, listening to every radio station you can find, watching all of the TV, all the news programming. . . . It still comes back to, who is the artist, and who is their audience? And how do you find them? . . . The number one reason why people don't go to a show, so they say, is that they don't know about it. Which is infuriating. But we just try to make that percentage of people . . . smaller, and smaller, and smaller."

When everything is going well, the company profits. "Where we like to do most of our business, and in fact is where we probably do 90 percent of our business, is in the venues that we own or operate, so that the risk profile of those shows goes down . . . we have more revenues coming in to ensure that we're able to cover the cost, including the cost of talent, and then walk away with a greater profit."[19]

Questions

1. Nederlander Concerts competes for music lovers with other concert arenas and promoters. Do you think it also competes with TV, movies, CDs, DVDs, streaming video, and sports events? If yes, what implications does this type of competition have for Nederlander's business?
2. How many different groups can you think of whose needs Nederlander Concerts must satisfy in order to be a successful business?
3. Give an example showing how Nederlander Concerts uses each of the four factors of production.

Case 1.2 — The Walt Disney Company Entertains the World

The company that brought Mickey and Minnie Mouse into the public eye has been entertaining families for 90 years. Although animation was the Walt Disney Company's original focus, its entertainment empire now spans four main business groups: studio entertainment (including movies, stage shows, and recorded music), parks and resorts (such as Disney World and the Disney Cruise Line), consumer products (toys, books, and other merchandise), and media (including broadcast television, cable television, and online media). Disney has its headquarters in Burbank, California, but its operations are spread around the world, with $41 billion in annual revenues and a workforce of 156,000 employees.

Over the years, Disney has acquired other businesses and started new businesses to further strengthen its competitive position and its profits. It owns Pixar, the movie studio responsible for *Toy Story* and many other animated films, and it established Touchstone Pictures to produce and distribute movies for wider audiences. It acquired the ABC television networks and the ESPN sports channels as part of its drive for global growth in multiple media. To expand into interactive media for children, Disney bought the popular Club Penguin site and began creating online and video games, many featuring its popular movie and television characters.

Founder Walt Disney didn't invent the theme park, but he did transform the industry with the 1955 opening of Disneyland in California. The magic continued with the 1971 opening of Disney World in Florida. Both theme parks were drawing crowds from every continent when the company opened Tokyo Disneyland in 1983, at the height of the Japanese economic boom. Later, it worked with international partners to create Disneyland Paris and Hong Kong Disneyland. Shanghai Disney Resort will be the next to open, the result of a $3.7 billion joint business venture with a Chinese company. In all, more than 120 million people visit Disney theme parks and resorts over the course of one year.

Disney sees great growth potential in China. Thanks to economic and political changes, Chinese consumers have more disposable income than ever before and more opportunities to exercise their higher buying power. Box-office receipts from Chinese movie theaters are growing at double-digit rates, and many of Disney's Hollywood blockbusters have also been big hits in China. At the same time, competition to get movies into Chinese theaters is enormous, because the government limits the number of foreign movies that can be distributed nationwide. With an eye toward the future, Disney worked with a local partner to co-produce *Iron Man 3* with a Chinese plot twist. It has also been lending its movie-making expertise to help develop the Chinese animation industry.

All these years of serving customers with a smile have given Disney considerable insight into how to meet the needs of people of all ages. The company set up the Disney Institute in 1986 to teach businesses, schools, hospitals, and other organizations how to deliver good customer service with the famous Disney touch. Its experts have trained National Football League staff members in preparation for Super Bowl events and given Chevrolet dealer employees tips about working with car buyers. When Florida Hospital asked for help in improving patient satisfaction, Disney experts conducted studies and recommended a number of steps, such as having a friendly greeter to put young patients at ease and replacing the glare of fluorescent bulbs with recessed lighting. These and other changes helped push the hospital's patient satisfaction scores into the top 10 percent across America. The Disney Institute's revenues have doubled over the past few years and are yet another reason for the company's profit momentum.[20]

Questions

1. How is the Walt Disney Company combining human, informational, material, and financial resources for business success?
2. What is Disney's competitive situation, and what are the implications for its future expansion and profitability?
3. Which of the factors in the business environment seem to be exerting the most influence on Disney's ability to grow? Explain.

Building Skills for Career Success

① SOCIAL MEDIA EXERCISE

Today, many companies have a social media presence on Facebook, Twitter, Flickr, and other sites beyond their corporate Web site. Think of three of your favorite car companies and conduct a quick search using a search engine like Google or Yahoo! Answer the following:

1. Name the social networks for each company.
2. Compare each of their Facebook pages. How many "likes" does each company have? Are there multiple pages for the company? How much interaction (or engagement) is on each Facebook page?
3. What business goals do you think each company is trying to reach through their Facebook presence?

② JOURNALING FOR SUCCESS

Much of the information in this chapter was designed to get you to think about what it takes to be a successful employee in the competitive business world.

Assignment

Assume that you are now 25 years old and are interviewing for a position as a management trainee in a large corporation. Also assume that this position pays $45,000 a year.

1. Describe what steps you would take to prepare for this interview.
2. Assuming that you get the management trainee position, describe the personal traits or skills that you have that will help you to become successful.
3. Describe the one personal skill or trait that you feel needs improvement. How would you go about improving your weakness?

③ DEVELOPING CRITICAL-THINKING SKILLS

With capitalism, competition is a driving force that allows the market economy to work. Let's see how competition works by pretending that you want to buy a new car.

Assignment

1. Brainstorm the following questions:
   a. Where would you go to get information about new cars?
   b. How will you decide on the make and model of car you want to buy, where to buy the car, and how to finance it?
   c. How is competition at work in this scenario?
   d. What are the pros and cons of competition as it affects the buyer?
2. Record your ideas.
3. Write a summary of the key points you learned about how competition works in the marketplace.

④ BUILDING TEAM SKILLS

Over the past few years, employees have been expected to function as productive team members instead of working alone. People often believe that they can work effectively in teams, but many people find working with a group of people to be a challenge.

College classes that function as teams are more interesting and more fun to attend, and students generally learn more about the topics in the course. One way to begin creating a team is to learn something about each student in the class. This helps team members to feel comfortable with each other and fosters a sense of trust.

Assignment

1. Find a partner, preferably someone you do not know.
2. Each partner has two to three minutes to answer the following questions:
   a. What is your name, and where do you work?
   b. What interesting or unusual thing have you done in your life? (Do not talk about work or college; rather, focus on such things as hobbies, travel, family, and sports.)
   c. Why are you taking this course, and what do you expect to learn? (Satisfying a degree requirement is not an acceptable answer.)
3. Introduce your partner to the class. Use one to two minutes, depending on the size of the class.

⑤ RESEARCHING DIFFERENT CAREERS

In this chapter, *entrepreneurship* is defined as the willingness to take risks and the knowledge and ability to use the other factors of production efficiently. An *entrepreneur* is a person who risks time, effort, and money to start and operate a business. Often, people believe that these terms apply only to small business. However, employees with entrepreneurial attitudes have recently advanced more rapidly in large companies as well.

Assignment

1. Go to the local library or use the Internet to research how large firms, especially corporations, are rewarding employees who have entrepreneurial skills.
2. Find answers to the following questions:
   a. Why is an entrepreneurial attitude important in large corporations today?
   b. What makes an entrepreneurial employee different from other employees?
   c. How are these employees being rewarded, and are the rewards worth the effort?
3. Write a two-page report that summarizes your findings.

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