Chapter 1: The U.S. Business Environment

Chapter Overview

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

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

* Describes global economic systems according to the means by which they control the factors of production.
* Shows how markets, demand, and supply affect resource distribution in the United States.
* Discusses the elements of private enterprise and the degrees of competition in the U.S. economic system.
* Explains the importance of the economic environment to busi­ness and identifies the factors used to evaluate the performance of an economic system.

Learning Objectives

1. Define the nature of U.S. business, describe the external environments of business, and discuss how these environments affect the success or failure of an organization.
2. Describe the different types of global economic systems according to the means by which they control the factors of production.
3. Show how markets, demand, and supply affect resource distribution in the United States, identify the elements of private enterprise, and explain the various degrees of competition in the U.S. economic system.
4. Explain the importance of the economic environment to business and identify the factors used to evaluate the performance of an economic system.

LIST OF in-class ACTIVITIES: instructor’s choice

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

CHAPTER OUTLINE

Learning Objective 1-1:

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

**The Concept of Business, and the Concept of Profit**

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

1. **Consumer Choice and Demand:** In a capitalistic system like that of the United States, consumers have freedom of choice. In turn, businesses must take into account consumer demand as shown through wants and needs in their pursuit of profits.
2. **Opportunity and Enterprise:** Unmet consumer demands provide promising opportu­nities for potential business success.
3. **The Benefits of Business:** Businesses produce most of the goods and services consumed, employ most working people, create new innovations, and provide opportunities for new businesses to serve as suppliers. Further, businesses contribute to the quality of life and the stan­dard of living in a society. Businesses provide incomes, taxes to support government, support to charities and community leadership.

**The External Environments of Business**

The **external environment** consists of everything outside an organization’s bound­aries that might affect it. Economists examine six major dimensions of the external environment. Managers must understand their environment to understand how to operate and compete within it.

1. **Domestic Business Environment.** The domestic business environment refers to the environment in which a firm conducts its operations and derives its revenues. It includes customers, suppliers, and competitors.
2. **Global Business Environment.** The global business environment refers to the inter­national forces that affect a busi­ness; various factors including international trade agreements, international economic conditions, and political unrest affect the global environment at both the general and immediate levels.
3. **Technological Environment.** The technological environment generally includes all the ways by which firms create value for their constituents; technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems.
4. **Political-Legal Environment.** The political-legal environmentreflects the relationship between business and government, usually in the form of government regulation of business.
5. **Sociocultural Environment.** The sociocultural environment includes the customs, mores, values, and demographic characteristics of the society in which an organization functions.
6. **Economic Environment.** The economic environment refers to relevant conditions that exist in the economic system in which a company operates.

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

**Time Limit:** **20 minutes**

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

**Time Limit: 25 minutes**

**Learning Objective 1-2:**

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

**Economic Systems**

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

**A. Factors of Production**

A basic difference between economic systems is the way in which they manage their resources, known as factors of production. Economists focus on five factors of production:

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

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

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

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

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

Key Teaching Tips

* The most important factors of production are entrepreneurial skills and informational resources. The more a country can create an environment that promotes entrepreneurship and harnesses knowledge and information, the better off it will be.
* Remind students that inputs used to produce outputs are also called *factors of production*; they include physical resources, labor, capital, entrepreneurship, and information resources.

Quick Questions

* What are the factors of production used to produce orange juice?
* Entrepreneurship involves tremendous risk-taking and is a welcome ingredient in a free-market system. What characteristics of our free-market system encourage risk taking?

**B. Types of Economic Systems**

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

1. **Planned Economies**: These systems rely on partial or total government control of all or most of the factors of production and allocation decisions. With **communism**—as currently operating in North Korea—all sources of production are owned and operated by the government.
2. **Market Economies**: Producers and consumers control production and allocation decisions through supply and demand. The political basis of a market economy is **capitalism,** which allows the private ownership of the factors of production and encourages entrepreneurship by offering profits as incentives. The economic basis is the operation of demand and supply.

3. **Mixed Market Economies**: This type of economy features characteristics of both planned and market economies; many countries are moving from planned systems to mixed market systems through **privatization,** which involves the transformation of government-controlled businesses into privately owned enterprises. In the partially planned system called **socialism,** the government owns and operates selected major industries. The U.S. Government’s bailout of U.S. banks and other financial institutions and corporations in 2009 involved the government taking an ownership stake to keep tabs on how tax dollars (used to bail out the banks and financial institutions) were being used. Critics of government intervention were quick to label the bailout as a move toward socialism.

Key Teaching Tips

* Remind students that a government’s level of control distinguishes capitalism from socialism. If you have foreign students in your class, you may want them to say a bit about the economic system in their native country.
* Make sure students under­stand that a *mixed market economy* is characterized by government ownership of major industries working alongside privately owned industries that smooth out fluctuations in output and unemployment and to (use and or to) stabilize prices.
* Remind students that an *economic system* is defined by how it allocates factors of production. In a *planned economy,* the government owns and controls these factors; in a *market econ­omy,* producers/consumers buy and sell what they choose.
* Make sure students under­stand that a *mixed market economy* is characterized by government ownership of major industries working alongside privately owned industries.
* Ask students to give their opinions about the government bailout of banks and financial institutions, as well as corporations in other industries, such as the automobile manufacturers. In addition, you could ask students to research and report on any new stories concerning the bailout that appear in publications such as the *Wall Street Journal.* It is never too early to get students to regularly read the business news!

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

Quick Questions

* Give an example of a coun­try with a planned economy.
* What makes this economy planned? Give an example of a country with a market economy.
* How is the eco­nomic system different in this country?
* In retrospect do you think the government bailout of banks, financial institutions, and automobile manufacturers was a wise move? Why or why not?

Learning Objective 1-3

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

**The Economics of Market Systems**

Market systems allow businesses the flexibility to decide what to produce, how much  
to produce, and what price to charge; customers are a driving force in market systems  
because they decide what to buy and at what price. Demand and supply are the predominant forces that guide decisions about what to buy and what to sell.

**A. Demand and Supply in a Market Economy**

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

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

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

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

c. Surpluses and Shortages: With a **surplus,** the quantity supplied exceeds the quantity demanded; quantity demanded exceeds quantity supplied with a **shortage.**

Quick Question

What is *equilibrium price*? What happens if incomes rise and demand increases? What happens if producers have a surplus and supply increases?

**B. Private Enterprise and Competition in a Market Economy**

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

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

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

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

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

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

d. **Monopoly**. An industry or market has only one producer; that producer enjoys complete control over price.

Key Teaching Tips

* Remind students that *perfect competition* is characterized by (a) many buyers, (b) many sellers, and (c) buyers and sellers who accept a going price.
* Remind students that *monopolistic competition* is characterized by (a) many buyers, (b) many sellers, and (c) products that are differentiated.
* Reinforce that *oligopoly* is characterized by (a) many buyers, (b) few sellers, (c) products that are quite similar, and (d) a change in price by one seller often meaning a change in price by all sellers.
* Remind students that a *monopoly* is characterized by (a) many buyers, (b) only one seller, and (c) prices being set by the one seller.

Quick Question

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

HOMEWORK

**Visit a Shopping Mall!**

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

**At-Home Completion Time: 1 to 1.5 hours**

Learning Objective 1-4

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

**Economic Indicators**

**A. Economic Indicators**

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

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

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

a. **Real Growth Rate:** Real growth depends on output increasing at a faster rate than population; the real growth rate in 2013 of the U.S. economic system was 1.8 percent while the population grew at a rate of 0.77 percent, thus indicating the real growth rate is modest.

b. **GDP per Capita:** GDP per capita means GDP per person. GDP divided by total population equals GDP per capita.

c. **Real GDP:** Real GDP means that GDP has been adjusted to account for changes in currency values and price changes.

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

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

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

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

**B. Economic Stability**

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

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

2. **Unemployment.** Unemploymentis the level of joblessness among people actively seeking work in an economic system; when unemployment is high, a surplus of available workers exists. Unemployment is sometimes a symptom of a **recession,** when aggregate output declines, or of a **depression,** a prolonged and deep recession. For example, during downturns in the business cycle people in different sectors may lose their jobs at the same time. As a result, overall income and spending may decline to the extent that businesses begin to implement cost saving measures—including reduction in force (downsizing), leading to more unemployment.

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

**C. Managing the U.S. Economy**

The government manages the U.S. economic system through both fiscal and mone­tary policies. **Fiscal policies** manage the collection and spending of revenues; changes in tax rates can function as fiscal policies. **Monetary policies** focus on controlling the size of the nation’s money supply; the government can influence banks to lend money and can influence the supply of money through stimulus packages. **Stabilization policy** is made up of both fiscal and monetary policies; the goal is to smooth out fluctuations in output and unemployment and to stabilize prices.

KEY TEACHING TIPS

* Make sure that students understand that *gross domestic product* includes only the value of products produced *within a nation’s borders;* the figure includes the value of products pro­duced by both domestic and foreign companies within those borders.
* Reinforce that *gross national product* includes the value of products produced by a country *regardless of where they are produced;* this figure does *not* include the value of products produced within the country by a foreign company.
* Emphasize that the govern­ment regulates the money supply and interest rates through *monetary policy*; the government influences money supply via taxation and spending through *fiscal policy*.
* Make sure students under­stand that *inflation* occurs when overall price levels go up because too much money is floating around; as a result, purchasing power declines.

**HOMEWORK**

**Interview a Business Owner**

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

**At-Home Completion Time: 1–2 hours**

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**IN-CLASS ACTIVITIES**

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

**Activity Overview**:

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

**Time Limit: 20 minutes**

**What to Do:**

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

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

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

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

**Don’t Forget:**

This activity allows students to get to know each other as well as set expectations for the course. The underlying agenda is to get them talking to each other, setting the stage for active participation throughout the class.

**Wrap-Up:**

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

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

**Activity Overview:**

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

**Time Limit: 25 minutes**

**What to Do:**

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

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

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

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

**Don’t Forget:**

Remind students that external environmental elements can change dra­matically, affecting specific industries differently over time.

**Wrap-Up:**

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

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

**Activity Overview:**

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

**Time Limit: 30 minutes**

**What to Do:**

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

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

**Don’t Forget:**

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

**Wrap-Up:**

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

ANSWERS FOR END OF CHAPTER ACTIVITIES

Questions for Review

1. What are the benefits of businesses? Can a business negatively affect society?

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

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

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

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

1-3. What is a demand curve? A supply curve? At what point do they intersect?

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

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

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

Questions for Analysis

1-5. Identify and describe at least three trends in the external environment that affect college enrollment. Explain how each trend affects colleges and universities.

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

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

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

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

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

1-8. At first glance, it might seem as though the goals of economic growth and stability are inconsistent with one another. How can you reconcile this apparent inconsistency?

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

Application Exercises

1-9. **Visit a Local Shopping Mall:** Visit a local shopping mall or shopping area. List each store that you see and determine what degree of competition it faces in its immediate environment. For example, if only one store in the mall sells shoes, that store represents a “local” monopoly. Note businesses that have direct competitors (two jewelry stores) and show how they compete with one another.

Answers will vary, but students should focus on the criteria for competition discussed in the chapter. For example, businesses with direct competitors operate within monopolistic competition; style, color, quality levels, and brand names often differentiate products. If only a few sellers of a product exist, as in an oli­gopoly, products will be quite similar, and a change in price by one seller will mean a change in price by all sellers. **(Learning Objective 3 – AACSB – application of knowledge)**

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

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

BUILDING A BUSINESS: CONTINUING TEAM EXERCISE 1-11 to 1-14

(Learning Objectives 2 and 3 – AACSB – interpersonal relations and teamwork, analytical thinking, application of knowledge)

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

The student should answer the following questions:

* What is my product or service?
* Who are my customers?
* Where are my customers located?
* Is my business idea easily copied?
* If there are substitutes for my product or service, how can I make my product/service stand out from competitors’ offerings?

TEAM Exercise: Paying the price of e-Business 1-15 TO 1-18

(Learning Objective 3 – AACSB – interpersonal relations and teamwork, analytical thinking, application of knowledge)

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

This market is best characterized as monopolistic competition: many sellers, many buyers, and differentiation required to attract buyers. In this scenario, differentiation will include equipment available, classes offered, quality of instructors, quality of customer service, and cleanliness of facility.

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

• A month after dropping prices by $5 per month, one of your competitors returns to your current pricing.

• Two of your competitors drop their prices even further, reducing membership costs by $8 per month. As a result, your business falls off by 25 percent.

• One of the competitors has announced that it will keep its prices low, but it will charge members $2 per session for high-demand classes such as Pilates.

• Each of the competitors’ that lowers the prices makes an adjustment, with reduced rates for families and couples, but they plan to return to $40 per month for single members.

• All four providers (including you) have reduced their monthly fees. One goes out of business, and you know that another is in poor financial health.

**Scenario 1:** Answers will vary, but should take into account the likelihood of this situation occurring. Because a competitor changes prices does not mean that you must follow.

**Scenario 2:** Again, following the trend and reducing prices is not mandatory, especially when you know you cannot afford it. What you can do is clearly indicate to customers and potential customers what makes your products and services (classes, equipment, facility) worth the additional $8 per month.

**Scenario 3:** A strategy for this scenario will be similar to that of Scenario 2, but specifically noting that your facility does not charge extra for any classes, regardless of demand.

**Scenario 4:** Consider whether you can match the reduced family and couples pricing, though you know you cannot reduce your price for individuals. The focus still needs to be on differentiation from your competitors, showing what advantages or benefits your gym offers. Consider adding programs specifically for families that are unique to your gym.

**Scenario 5:** Having reduced your prices is causing you financial problems, as you expected. However, if supply is diminishing through the reduction and/or weakness of competitors, that means demand for the remaining services should increase. This increase in demand should result in increased customers for your gym. You may be able to consider increasing your fees again shortly.

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

Classes that other gyms do not offer, or schedules that meet customer demand better than the competitors can draw in new buyers. Social events, group training for an upcoming 10K, for example, could attract new members. Offering family oriented services, such as children’s classes, or even childcare, would be unique. The main point that students should focus on is that a price war is not a winnable strategy. Newsletters and relationship building activities (since working out with friends is a well-known motivational tool) can keep people connected, to each other and the gym.

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

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

Exercising Your Ethics: GETTING CAUGHT OUT IN THE COLD

(Learning Objective 2 and 3 – AACSB – ethical understanding and reasoning, reflective thinking)

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

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

1-20. What are the underlying ethical issues?

Underlying ethical issues revolve around generating maximum pricing versus generating an acceptable profit, while giving customers an even better deal than the locked in price of $3.80 per gallon.

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

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

CASES:

WHAT GOES UP…CAN ALSO COME DOWN!

(Learning Objectives 3 and 4 – AACSB – application of knowledge, reflective thinking)

1-22. What has happened to gasoline prices since the beginning of 2015? You can find monthly average price data from the U.S. Energy Information Administration at [www.eia.gov](http://www.eia.gov).

Answers will likely vary somewhat based on students’ interpretation of the data. Price trends will also be affected by geographic differences in supply, demand.

1-23. Explain how the concepts of the demand and supply of petroleum combine to determine market prices.

Future demand should grow as economies recover from the global recession with emphasis on surging demand in Asia and South America. Students should also discuss the decline in the physical supply of petroleum which combined with changes in demand will lead to lower production and higher prices.

1-24. What economic indicators are most directly affected by energy prices?

The economic indicators most directly affected by energy prices are: GDP, Balance of Trade, and inflation.

1-25. Does the global energy situation increase or decrease your confidence in a capitalistic system based on private enterprise?

Students will have totally different perspectives, generating much discussion.

1-26**.** Should there be more government intervention in the exploration for and pricing of petroleum products? Why or why not?

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

TAKING A BITE OUT OF INTERNET RADIO

(Learning Objectives 1 and 3 – AACSB – application of knowledge, reflective thinking)

1-27. Identify the external environments of business that will affect the success or failure of Apple’s iTunes Radio.

Students should focus on the competitive, social, technological, and economic factors that will affect the success or failure of Apple’s iTunes radio.

1-28. What factors will influence the demand for iTunes Radio?

After students conduct their environmental analysis, they should be able to identify several factors (both positive and negative) that will impact demand.

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

Students should focus on the characteristics of the competitive structure and which best fits the Internet radio market.

1-30. To customize your listening experience, Internet radio services collect data on your listening habits. Are you comfortable with this use of “big data?” Why or why not?

Students will probably have very mixed responses depending on their perspective on privacy on “data mining.”

1-31. Do you think that Apple will be successful in this new venture? Do you think that it was a wise decision for them to enter the already crowded market?

Some students will think that the market is too crowded already and Apple should not undertake this venture; others will note the success of the Apple brand and the goodwill it generates. Those students will focus on the opportunities for success.

Once students have answered the questions, discuss their answers as a class. As students discuss their answers, make sure they touch on some of the following points. Technological changes are frequent and sometimes market changing. Even since the case was written, the music-streaming market has changed, and Apple’s place in that market is changing through the company’s purchase of Beats, and its addition of news and sports content to iTunes Radio. Economically, students should consider the various price points offered by the various competitors and how much price is likely to influence a user. How much does loyalty matter to users? Do specific features offered by iTunes Radio, Spotify, Rdio, Pandora, or any of the others help create loyalty and preference?