

# **CHAPTER 1**

## **UNDERSTANDING THE CANADIAN BUSINESS SYSTEM**

### **CHAPTER SYNOPSIS**

Chapter 1 creates a context for understanding the business concepts that are presented throughout the text. This chapter presents the ideas of business and profit, outlines the world's major economic systems, and describes the key aspects of Canada's market economy, including markets, demand, supply, private enterprise, and the different degrees of competition that are evident in various industries. An Appendix at the end of the text provides a brief history of business in Canada.

### **CHAPTER OUTLINE**

#### **I. THE IDEA OF BUSINESS AND PROFIT**

A business is an organization that seeks to earn profits by providing goods and services to customers. Profit is what remains after a business's expenses incurred are subtracted from its sales and revenues. Profits are what encourage people to open and expand business and are required in order for the organization to be "a going concern." In Canada, not-for-profit organizations such as charities, educational institutions or government agencies are also important. As the term suggests, these are organizations that do not try to make a profit; instead, they use the funds they get from government grants or from the sale of goods and services to provide various services to the public.

#### **II. ECONOMIC SYSTEMS AROUND THE WORLD**

An economic system is the way in which a nation allocates its resources among its citizens. Various systems differ in terms of who owns or controls these resources, or "factors of production."

A. Factors of Production—The basic resources used by a business to produce goods and services include natural resources, human resources, capital, entrepreneurs, and information.

1. Labour—The people who work for a company.
2. Capital—The funds needed to operate a business.
3. Entrepreneurs—Those people who accept the opportunities and risks involved in creating and operating a business.
4. Natural resources—Land, water, mineral deposits, trees and other naturally occurring resources that businesses need to operate.

5. Information—Market forecasts, specialized knowledge possessed by employees, and various forms of economic data about the economy and consumers that are used by businesses.

B. Types of Economic Systems—Different types of economic systems manage the factors of production in different ways. Command economies, market economies, and mixed economies are three basic types.

1. Command economies—Government controls many (or all) of the factors of production. The government decides how much will be produced and who will produce it. Command economies have fallen into disfavour during the past decade, and only a few are left (e.g., Cuba and North Vietnam).

2. Market economies—Factors of production are controlled by markets, not by government. Individuals are free to start their own businesses, and consumers are free to buy from whomever they wish.

a. Input and output markets—In input markets, companies buy resources from households; in the output market, companies supply goods and services in response to demand from households.

3. Mixed market economies—Have features of both command and market economies. Most countries of the world, including Canada, have mixed market economies.

### **III. INTERACTIONS BETWEEN BUSINESS AND GOVERNMENT**

A. How Government Influences Business—The government influences business by taking on the roles of customer, competitor, regulator, taxation agent, provider of incentives, and a provider of essential services.

1. Government as a customer—Government buys many services and products which amount to billions of dollars each year.

2. Government as a competitor—Crown corporations at both federal and provincial levels compete with business.

3. Government as a regulator—The federal and provincial governments regulate many aspects of business activity, including the following:

a. Promoting competition—Competition policy seeks to eliminate restrictive trade practices to stimulate maximum business

activity. The guidelines for Canada’s competition policy are contained in The Competition Act.

b. Protecting consumers—The Canada Consumer Product Safety Act, the Tobacco Act, Weights and Measures Act, Textile Labelling Act, and the Food and Drug Act, are examples of regulations that protect consumers.

c. Achieving social goals—The achievement of social goals promotes the well-being of our society. Social goals include universal access to health care, safe workplaces, employment insurance and decent pensions.

d. Protecting the environment—Legislation to protect the environment includes the Canada Water Act, the Fisheries Act, and the Environmental Contaminants Act.

4. Government as a taxation agent—Taxes are imposed and collected by all three levels of government. Revenue taxes (e.g., income taxes) are levied primarily to fund government services and programs; they form the majority of all taxes. Progressive and regressive taxes are described. Restrictive taxes, such as excise taxes on alcohol, tobacco and gasoline serve as both a revenue source and a “deterrent to excesses.”

5. Government as a provider of incentive programs—These programs are intended to stimulate economic development. Governments offer numerous incentive programs through various government organizations. Several examples of grant incentive programs are described. Incentives are also provided through the services provided to companies by the government (several examples are given).

6. Government as a provider of essential services—Business activity is facilitated by the government services that are supplied, e.g. roads, postal service, police and fire departments.

B. How Business Influences Government—Business can influence governments through the use of lobbyists, trade associations, and advertising.

#### **IV. THE CANADIAN MARKET ECONOMY**

A. Demand and Supply in a Market Economy—Markets, demand, supply, the law of demand, the law of supply, equilibrium, surplus, and shortage are defined.

1. The laws of supply and demand—Demand is the willingness and ability of buyers to purchase a product or service. Supply is the willingness and ability of producers to offer a good or service for sale.

2. Demand and supply schedules—Show how many units of a product are likely to be sold at various prices.
3. Demand and supply curves—A demand curve shows how many products will be demanded at different prices, while a supply curve shows how many products will be supplied at different prices.
4. Surpluses and shortages—When the quantity demanded exceeds the quantity business are willing to supply, a shortage exists. When the quantity demanded is less than the quantity businesses are willing to supply, a surplus exists.

## **V. PRIVATE ENTERPRISE AND COMPETITION**

Adam Smith’s belief that allowing individuals to pursue self-interest would eventually benefit society as a whole through “the invisible hand of competition” is discussed. Four elements must be present in private enterprise: private property rights, freedom of choice, profits and competition.

- A. Degrees of Competition—Four degrees of competition within private enterprise are identified. Examples of each are given.
  1. Perfect competition—A market or industry characterized by a large number of small firms producing an identical product so that no one firm is powerful enough to influence the price of their product in the market place. Agriculture (wheat production) is given as an example.
  2. Monopolistic competition—A market or industry characterized by a large number of firms supplying products that are similar but distinctive enough from one another to give firms some ability to influence price. Examples given: detergents, soft drinks, fashion.
  3. Oligopoly—A market or industry characterized by a small number of large firms that have the power to influence the price of their product and/or resources. Generally large initial capital investment is necessary for new competitors to enter the market, therefore, barriers to entry are high. Examples given: automobile, rubber, and steel industries.
  4. Monopoly—A market or industry with only one producer, who can set the price of its product and/or resources. Natural monopolies like provincial utilities are described.

## QUICK QUESTIONS

1. What are the factors of production used to produce a litre of orange juice?
2. Entrepreneurship involves risk-taking, which is an important ingredient in a free-market system. What characteristics of our free-market system encourage risk-taking?
3. Give an example of a country with a planned economy. What makes this economy planned? Give an example of country with a market economy. How is the economic system different in this country?
4. What is an equilibrium price? What happens if incomes rise and demand increases? What happens if producers have a surplus and supply increases?
5. Which level of competition best describes the market in each of the following scenarios: Your local pizza restaurant? A local farmer selling apples for applesauce? Gap jeans?

## IN-CLASS EXERCISES

### **Exercise #1: 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 if they are having difficulty coming up with items to list, take a look at the table of contents of 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)

*Part 1—Introducing the Contemporary Business World*

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.

**Exercise #2: Comparing Economic Systems**

**Activity Overview:**

This activity gets students talking about the similarities and differences between the Canadian economic system and other economic 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, “Canada 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, it will be very interesting to hear them describe the characteristics of the economic system in their native country.

**Wrap-Up:**

Wrap up the discussion by reminding students that the Canadian 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 Canada as well as various aspects of the market through agencies such as the Hazardous Products Act, The Food and Drug Act, and the Canadian Radio-Television and Telecommunications Commission.

### **Exercise #3: Is Competition Good?**

#### **Activity Overview:**

This activity asks students to think about competition and the role that it plays in our economic system.

**Time Limit:** 45 minutes

#### **What to Do:**

1. Ask students to think about competition as an essential ingredient in a free-enterprise system.” (10 minutes)
2. Divide the class into small groups and ask them to discuss and make notes on some situations in which competition is good for the Canadian economy and some situations in which competition is bad for the Canadian economy. Group members should try to reach agreement. (15 minutes)
3. Regroup the class and ask the groups to explain the rationale for their answers, asking for feedback from the class as the various situations are discussed. On what parts of the discussion does the class agree or disagree? (15 minutes)
4. Ask the class to come to a consensus: Is competition good or bad? (5 minutes)

#### **Don't Forget:**

If the class cannot arrive at a consensus, they might consider voting.

#### **Wrap-Up:**

Remind students that competition is an essential part of a free-enterprise system, as entrepreneurship invites competition in many industries. Not every enterprise will succeed in the marketplace, but competition does hold prices at market level and contributes to a high quality of goods and services.

### **TEACHING TIPS**

1. Individuals set up businesses in Canada with the intention of making a profit. As a course opener, ask students to provide a definition for the term “profit.”
2. Though the definition of business includes profit as a motive, remind students that most business principles also apply to not-for-profit organizations.
3. There have been business people who have said: “For me, making a profit is NOT the most important thing about operating my business!” Ask students to identify some other good reasons for opening a business and going through the work of making that business a successful venture.

*Part 1—Introducing the Contemporary Business World*

4. Have the students imagine a typical new small business that has just completed its first period of operation. If there are profits from operations, where are some places to which these profits might be allocated? Have students make the list as long as possible.
5. Most, if not all, of the students have heard of non-profit or not-for-profit organizations. Ask the students to explain what such terms mean. Is there really such a thing as a non-profit organization?
6. Profits reward owners for taking the risks involved in investing their money and time in a business. Ask students to describe some of the risks involved.
7. Remind students that inputs used to produce outputs are also called factors of production; they include physical resources, labour, capital, entrepreneurship, and information resources.
8. As a way to make the factors of production—labour, capital, entrepreneurs, and natural resources—stay with the students, engage in a synonym game. Ask students, perhaps in teams, to develop a string of synonyms for the four factors. Here’s an example: “people, money, risk takers, and raw materials.”
9. Ever since the factors of production were first proposed, various individuals have attempted to indicate which of the four is most important. Have students do the same. Usually entrepreneurs come out ahead. However, you can point out that all are needed and making one of them the “star” could be a mistake.
10. It has been said that entrepreneurs are a special breed. Encourage some students to indicate why they would or would not like to be an entrepreneur.
11. Ask students to evaluate this statement: “An owner of a business can take more time away from work than a hired employee can.”
12. 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.
13. Encourage students to see the logic behind some of the ideas that Karl Marx espoused. Students should also be encouraged to take from Marxian theory several notions that we accept in Canada today.
14. If students agree that some Marxian ideas truly have merit, they are ready to tackle a timely question: “What has gone wrong in so many nations that have tried to follow the teachings of Marx?”
15. Ask students to do some investigative research on the status of human rights in communist countries like Cuba, North Korea, and Vietnam. Is there a common thread?



If students find a common thread, ask them this: “What seems to be the relationship between communism and the value placed on the rights of the individual?”

16. Cuba is on the list of communist countries. Assume that tomorrow morning, Castro calls the Canadian Prime Minister and says: “I want to restore economic stability to my country. Please help me!” Appoint one of your students (or a student team) as High Commissioner for Economic Restoration in Cuba. What will that student (or student team) do to help Cuba?

17. Have students reveal what picture comes to mind when someone uses the term “capitalist.” Is the first reaction positive or negative? Why?

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

19. Ask students to give examples of how government plays each of the roles mentioned in the text (customer, competitor, regulator, taxation agent, provider of incentives and financial assistance, and provider of essential services).

20. Price represents a balance between supply and demand, so consumers should be able to do a lot to determine prices of products and services. Why do consumers often feel that they have little or no power over prices they are charged?

21. Ask the students to show ways in which consumers can cause the price of certain products to fall.

22. Degrees of competition are best taught through liberal use of examples. Moderate a class discussion where the goal is to develop examples of each of the four degrees of competition.

23. What degree of competition exists in professional hockey? In major league baseball?

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

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

26. 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 means a change in price by all sellers.

27. The concept of the “invisible hand of competition” is often hard for students to grasp. Help them understand the concept by working through an example which begins with an individual perspective and show how many individuals working for their own

*Part 1—Introducing the Contemporary Business World*

benefit actually benefit a much larger group of people. Price reductions, which occur over time in products (e.g., electronic calculators or computers) are good examples.

28. Remind students of the importance of learning the key terms in the text. Although the “jargon” of a field of study can be annoying to some, it provides a useful shorthand for describing concepts and learning about the field.
29. Remind students that in an introductory course the material is not covered in depth. Rather, the approach is to “sample” all the important areas of business.
30. One of the review questions at the end of the chapter asks students to give examples of the four basic degrees of competition. Ask students to share these in class.
31. Have students interview an entrepreneur and ask the person about their experiences. Have students make a brief report to the class about their findings.
32. Have students make a list of products they use every day. Compile a master list as part of a class discussion. Most will be surprised at how long the list is.
33. One way to end the chapter discussion is to play a form of Jeopardy with the class. Divide the class into teams and ask teams quick questions about the chapter material. The winning team continues to get the first chance to answer until they lose to another team. You, the instructor, serve as timekeeper, scorer, and moderator.

### **USING THE BOXED INSERTS**

#### **Opening Case: Spin Master: From Canadian Toy Maker to Global Children’s Entertainment Company**

This case study tells the story of Spin Master, a company started by three entrepreneurs about 25 years ago, that originally focused mainly on developing and selling children’s toys. It has now grown from a one-product company to a large international company that is involved in several areas beyond children’s toys.

#### **Questions for Discussion**

1. Based on what you read in this feature, what are the primary reasons for the long-term success of Spin Master?

There are two primary reasons for Toy Master’s long-term success. First, the entrepreneurs who founded the company learned important lessons about business activities such as sales, manufacturing, and finance as a result of their initial market offering of a single product called Earth Buddy. Their success with that product, in turn, motivated them to expand their thinking about the kinds of products they could sell, and to find new ways to satisfy customer demand.

Second, the entrepreneurs have been very aggressive in searching for new product ideas, and when necessary, acquiring other companies in order to broaden Spin Master's product offerings.

Now the company has over 1,500 employees and it describes itself as *“a leading global children's entertainment company that creates, designs, manufactures, licenses, and markets a diversified portfolio of innovative toys, games, products, and entertainment properties.”*

2. In what ways does Spin Master demonstrate the basic principles of business, the power of entrepreneurship, and creativity in a global economy?

Two key principles of business in a country like Canada are the profit motive and the need to satisfy consumer needs. Spin Master illustrates both of these principles, and has from its inception.

In order to survive and be profitable, the entrepreneurs had to first come up with a new product that would appeal to the market and would satisfy consumer needs. It was also necessary to coordinate marketing, production, finance, and human resource activities in order to get the product to a large number of consumers. All of this had to be done in such a way that the company was profitable (i.e., its sales revenues exceeded the costs that were incurred to develop and market products).

The power of entrepreneurship is evident in the risk-taking behaviour of the three founders when they started the company 25 years ago. There was no guarantee that they would be successful, but with a great deal of hard work and interesting new product choices, they succeeded in gradually building their company into the significant market force that it is today. The creativity they demonstrated as they developed new products for the international market was crucial in the company's success.

3. In this chapter, we will discuss the different types of economic systems. After reading that section, answer the following question. What features of the Canadian economy helped make Spin Master's success a reality? In what ways would this task have been more difficult in a command economy? Explain.

The most fundamental feature of the Canadian economy that helped to make Spin Master a success is freedom of choice, i.e., in a market economy, entrepreneurs are free to develop products that have the potential to satisfy consumer needs, and consumers are free to either accept or reject such products. Success is not guaranteed; rather, it depends on how well the company's product offerings actually satisfy customer needs.

This contrasts sharply with the situation in a command economy, where the central government controls the factors of production and makes production and allocation decisions. Over the past 50 years, there has been a global movement away

from command economies and toward market economies because market economies do a much better job of satisfying consumers than command economies do.

4. What are the greatest challenges facing Spin Master today? What do they need to do to thrive for another 25 years or more?

One of the greatest challenges facing Spin Master is the general decline in toy sales. As noted in the case study, other products (e.g., cell phones) have become interesting even for younger children, and this has suppressed the sales volume of traditional children's toys. Spin Master can meet this challenge by continuing to do what they have done over the past 25 years, i.e., constantly look for new products that will satisfy emerging consumer needs. This might mean, for example, introducing more electronic products instead of traditional ones like teddy bears.

Another challenge is the issue of distribution. The case study notes, for example, that the decline of Toys R Us was partly due to the growth of online sales at the expense of sales at bricks-and-mortar stores. One way to get students involved in this issue is to ask them to research how Spin Master distributes its products and what its online presence currently is.

### **Disruptions in Business: Disruptions Everywhere!**

This insert describes how technological and other changes have impacted the way businesses operate. As noted in the insert, all these changes that are occurring mean significant improvements for consumers in the form of new and useful products and services, but they also pose a real threat to the financial health of certain businesses, to the investors who buy their stock, and to the managers and workers who are employed by them.

### **Critical Thinking Question**

1. Consider the following statement: *The disruptions that are increasingly evident in the Canadian economy increase stress levels and the complexity of people's lives. We should be more concerned about our quality of life than we are about new gadgets and new ways of doing things.* Do you agree or disagree with the statement? Explain your reasoning.

The statement asks students to seriously think about the impact that technological and other changes have had on peoples' quality of life. Or, put another way, is the "quality" of life more important than the "quantity" of life? This has actually been an ongoing debate for decades in North America. While the vast array of products and services that are available promise to make our lives better, for many people there is a hollowness to the pursuit and acquisition of material goods and a feeling that "there must be something more to life."

An in-class debate that is moderated by the instructor will bring out the major pro and con points regarding this issue. While it is unrealistic to assume that there will be an easy consensus on this issue, the main point is that students will hear arguments for positions that they do not hold and will have to consider the merit of those arguments.

Students who disagree with the statement will probably focus on the convenience that they have experienced when using “gadgets,” and since they have had a positive experience using those gadgets, they may not see much merit in the statement and may therefore not give much additional consideration to the possible downside of rapid change. By contrast, students who agree with the statement may argue that it is not healthy for businesses to obsessively pursue profits and for consumers to obsessively pursue the acquisition of material goods. Those students may conclude that when that situation exists, truly important questions about the meaning of life, living in community, caring about each other, and the spiritual welfare of people are ignored. This type of comment may seem out of place in a business course, but increasing numbers of people in society are questioning the priorities that businesses and consumers have.

To help students work through this fundamental issue, it is useful to pose questions that require them to think about both the positive and negative aspects of our highly materialistic society. Illustrative questions: (1) “Does rapid change in society increase stress levels of people”? (2) “What are the implications of rapid change for investors, workers, and managers”? (3) How does rapid change affect human interactions”? (4) To what extent does a materialistic emphasis in a society affect how people treat each other”?

### **The Greening of Business: Problems in Ontario’s Power System**

This insert describes the problems that have occurred in Ontario’s electrical power system as that province is trying to become a world leader in renewable energy. Things haven’t worked out as planned, and electricity bills for consumers have doubled over the past decade.

#### **Critical Thinking Question**

1. Consider the following statement: *“The criticisms that have been levelled at the Ontario government are unfair. While electric bills have gone up, the fact is that the movement to green energy sources like wind and solar is necessary to cope with the threat of climate change. The Ontario government has done the right thing by protecting the long-term quality of life for its citizens.”* Do you agree or disagree with the statement? Defend your reasoning.

This boxed insert, and many of the others in this textbook as well, are designed to motivate students to think critically about a wide variety of issues that affect both businesses and consumers. The statement that students are asked to consider contains phrases that are certain to generate debate among students. For example, the phrase “the

movement to green energy sources like wind and solar is necessary to cope with the threat of climate change” will immediately be challenged by some students and strongly endorsed by others. This gives the instructor an opportunity to moderate an in-class debate about climate change and its impact on the province of Ontario.

Attention on these issues can be focused by assigning two groups to respond to the statement. One group should be asked to develop reasons for disagreeing with the statement and the other group should be asked to develop reasons for agreeing with the statement. Each group can make a 10-minute presentation, which will be followed by an open discussion about the merits of the positions espoused by the two groups. The instructor can then determine the extent of consensus as a result of the open discussion.

As a result of the group presentations, it is likely that two specific issues will be debated: (a) the reality of climate change, and (b) the role of government in responding to perceived environmental threats. Since there are such strong ideological positions on both of these issues, the presentation of evidence and the critical thinking about what that evidence means is crucial. Each group’s position on these two issues should therefore be assessed on the basis of the evidence they present to back up their claims.

To increase student interest in this exercise, a 5-step process can be used. First, poll class members to determine what proportion of the class agrees with the statement and what proportion disagrees with it. Second, have the two groups make their presentations. Third, moderate an in-class debate. Fourth, poll students a second time and observe whether the proportion of “agree” and “disagree” has changed. Finally, determine *why* certain members of the class changed their mind, and in what direction they changed.

### **E-Business and Social Media Solutions: The Lucrative Business of App Development**

This boxed insert describes how several entrepreneurs have become very wealthy as a result of developing social media applications such as Snapchat, Twitter, and What’sApp.

#### **Critical Thinking Question**

1. Look at the most recent statistics available on Snapchat. Is their user base still growing? Do you believe Snapchat is gaining popularity or do you see another new application eating into Snapchat’s base?

Student answers will vary depending on when they take the introduction to business course. When assessing student answers, make sure they have reported accurate statistics on Snapchat’s user base, and that they have a time series so that trends can be seen. Also examine student conclusions about Snapchat’s popularity to see if they match with actual usage numbers. For example, a given student might find very Snapchat very attractive and conclude that many other people feel the same way. But this personal view may not be supported if a person looks at actual usage data.

Other competitors to Snapchat may well have emerged by the time some students take the introduction to business course. It is often the case that a new idea suddenly becomes very popular, but soon other entrepreneurs refine the idea and become strong competitors to the original new idea. For example, one entrepreneur started the Dollar Shave Club, which sells razor blades online (see the Disruptions in Business boxed insert in Chapter 13). But soon after, another entrepreneur started Harry's Labs which is a direct competitor of the Dollar Shave Club. Both of these upstarts have cut into the market share of existing large companies like Gillette and Schick.

## QUESTIONS AND EXERCISES

### Questions for Analysis

1. 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. Students may have difficulty coming up with an example of a product where a surplus has led to decreased prices, but most of them will use oil as an example of a product where a shortage has led to increased prices (although depending on the time frame of analysis, they could obviously also use oil as an example of a product where a surplus led to decreased prices). It is likely that the examples students come up with will be consistent with what economic theory predicts. That is, the law of demand states that buyers will purchase (demand) more of a product as its price drops. Conversely, the law of supply states that producers will offer more for sale as the price rises. If there seem to be inconsistencies, analyze why they might exist (for example, too short a time frame of analysis).

2. The Canadian government provided export assistance to Bombardier Inc. with its Technology Transfer Program. Is this consistent with a basically free market system? Explain how this might distort the system.

Government incentive programs may or may not have the desired effect of stimulating the economy. The free market is one in which decisions about what to produce and in what quantities are made by the market- that is the buyers and sellers negotiating prices for goods and services. Financial incentives by government are inconsistent with a free market system.

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

Most student answers will probably focus on how inflation and unemployment negatively affect them. A high rate of inflation will, for example, increase their cost of living, while a high unemployment rate will increase the difficulty of finding a job in

order to help pay for their living costs. But some answers will go beyond this personal focus, and will describe how other people (parents, friends, the poor, etc.) are negatively affected by high inflation and high unemployment. It is useful to list on the board all these negative effects so that class members can understand why a lot of attention is paid to these two factors. But it is also important to take note of the positive effects of low inflation and low unemployment.

Inflation and unemployment levels affect managers in many ways. For example, in periods of high inflation, decisions about pricing policies are very important, and a balance must be achieved between covering the increased costs of production and maintaining demand levels from consumers. High unemployment levels mean that managers have a larger pool of prospective employees to choose from, while low unemployment levels may mean that managers have difficulty finding qualified people to fill job vacancies. Because there are so many possibilities here, it is once again useful to list all the ideas that students come up with as they consider the impact of inflation and unemployment on business managers.

4. Familiarize yourself with a product or service that is sold under conditions of pure competition. Explain why it is an example of pure competition and identify the factors that make it so. Then do the same for a product in each of the other three competitive situations described in the chapter (monopolistic competition, oligopoly, and monopoly).

Answers will vary. This is a good exercise for assisting students in understanding that not all industries are equally competitive.

5. Government plays a variety of roles in the Canadian mixed economy (customer, regulator, taxation agent, provider of services, etc.). Consider each of the roles discussed in the text and state your view as to whether government involvement in each role is excessive, insufficient, or about right. What criteria did you use to make your assessment?

Answers will vary. Some government rules and regulations are necessary to make sure that all of a business's stakeholders are protected and that people who are unable to work get the basic care they need.

### **Application Exercises**

6. Visit a local shopping mall or shopping area. List each store you see and determine what degree of competition it faces in the immediate environment. For example, if there is only one store in the mall that sells shoes, that store represents a monopoly. Note the businesses with direct competitors (for example, two jewellery stores) and describe how they compete with each other.

This assignment will provide students with an opportunity to understand different degree of competition in a setting where they spend a fair bit of their time.



7. Pick a specific product that you use. Explain how the factors of production work together to make that product available.

There are many examples that students could use. One example is a meal purchased at a restaurant. The restaurant owner is the entrepreneur who is operating the business for profit and risking the possibility of failure. The business employs a variety of chefs, cooks, managers, wait staff, kitchen staff, and cleaners. The entrepreneur may or may not be employed in the operation of the restaurant, and may or may not do the hiring of all the staff members, depending on the size of the restaurant. While most of the staff members are hired for their physical skills, the chef must have creative talents to make the business successful. Most restaurants are privately owned, and therefore financed by the owner's personal resources, credit from suppliers, bank or credit union financing, and possibly loans from friends and family. Another important source of financing is cash flow provided by the profitable operation of the restaurant. The natural resources employed include the land on which the restaurant is situated.

8. 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.

This should be an interesting exercise for students. Have them categorize the factors of production to make class comparison easier. After the information is brought back to class, have a class discussion about (1) whether supply and demand issues vary across businesses, (2) whether some businesses have an "easier" time locating the factors of production and why, and (3) how fluctuations in economic factors affect the business.

## TEAM EXERCISES

### **Building a Business: Continuing Exercise**

In this initial stage of building their business, groups should consider the various external environments (see Chapter 2 in the text) as they try to identify three trends that will create business opportunities.

Groups must also answer some very fundamental questions about their business in this initial stage of their work. These questions are:

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

## **Building Your Business Skills: Analyzing the Price of Doing Business**

### **Follow-Up Questions**

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

Encourage the students to think about “what do they look for when they are considering a service provider.” They should look at the company (e.g., its reputation and reliability) as well as the actual services that it offers (e.g., the range of fitness equipment that is available, the variety of classes that are offered, other inducements that are designed to attract customers, etc.).

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

No, it depends on many factors, including the reputation of the company, the image that it is trying to portray, competitive factors in the market, the company’s financial position and cost structure, the company’s market share, etc. Sometimes a business fails because it cuts prices below the cost of providing the products or services.

Another factor that should be brought into the discussion is the impact of the decisions that teams made as they responded to the requirement to develop specific pricing strategies to deal with the five different competitive situations that are presented in the exercise. Ask teams what criteria they used to set prices, and how much thought they gave to the impact of their pricing strategies on the company’s profitability and market share.

3. Eventually, what form of competition is likely to characterize this market?

The trend in some industries (e.g., airlines) is for bigger firms to buy out the smaller firms to the point that an oligopoly emerges. But most firms in an oligopolistic industry avoid price competition because it reduces profits. As well, entry into the market is limited because of the large capital investment that is required. Neither of these characteristics is evident in the gym and fitness studio market that is described in this exercise. It seems that the most likely form of competition in this market will be monopolistic competition (fewer sellers than in perfect competition, but still many buyers). There may be some large companies, but small companies can successfully compete by focusing on a niche image and product differentiation. This will allow competition on the price dimension.

## **Exercising Your Ethics: Team Exercise: Getting Caught Out In the Cold**

### **Activity Overview:**

This activity asks students to examine the economic and ethical issues that can arise when making business decisions.

**Time Limit:** 35 minutes

**What to Do:**

1. Divide students into four-member teams. Ask them to read the description of the situation and then answer the three questions that follow. (20 minutes)
2. Reassemble the class as a whole and have each group briefly give its answers to each of the three questions. (15 minutes)

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

Seema anticipates that the supply of heating oil will be higher this winter, resulting in the need to charge less than last winter. She also believes that demand will increase if the company offers consumers the option of locking in a price, since that price is lower than what customers 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.

2. What are the underlying ethical issues?

Underlying ethical issues revolve around the dilemma of wanting to charge customers a “reasonable” price, but also wanting to build up financial resources because of tough times for the company during the last few years.

3. What would you do if you were actually faced with this situation?

Answers will vary, but student answers must demonstrate an understanding of the ethical issue that is evident, as well as an understanding of the pros and cons of each possible action the company might take.

**Don’t Forget:**

Remind students that there is typically an interaction between economic incentives and the level of ethical behaviour that is evident.

**Wrap-Up:**

There is seldom a yes/no, right/wrong, black/white answer to ethical decisions in business. One rule of thumb is to make the decision that positively affects the greatest number of people. But rules of thumb might or might not work in a given situation.

## CASE ANALYSIS

### **Business Case 1: Alphabet: G is for Google**

#### **Questions for Discussion**

1. What are the secrets to Google's success? What role, if any, did luck play?

There are several secrets to Google's success. First, Brin and Page have interests and training in computer science. That training did not guarantee that they would be successful, but it meant that Brin and Page could use that knowledge as a base for coming up with innovative ideas that turned out to have tremendous commercial value. In other words, their knowledge was a necessary, but not sufficient, condition for their success. Second, they are highly motivated and they constantly refined their ideas. The combination of hard work and sound technical training were instrumental in their success. Third, they are innovative thinkers who have been able to sense products and services that will be in high demand by consumers. This focus on innovation is clearly one of Google's greatest strengths. Fourth, they are opportunistic. When they ran across the description of a business model based on the concept of selling advertising in the form of sponsored links and search-specific ads, they adapted it to their own concept and went into business for themselves. Fifth, they have been insightful enough to purchase other companies (for example, YouTube, Android, and DoubleClick) that complement Google's original strategy. Sixth, they have a clear and consistent mission: to organize the world's information and make it universally accessible and useful. Seventh, they have focused on attracting talented and creative employees and provided them with a work environment and culture that fosters productivity and high levels of innovation.

Luck did play a role in the sense that when they tried to license the technology they had developed, they couldn't find any buyers. At the time, that seemed like a drawback, but it forced them to look for their own investment capital so they could keep refining and testing their search product. Because of that, they ended up running their own company, and that has given them far greater financial returns than they would have received from simply licensing their search engine idea.

2. Describe the factors of production as they relate to Alphabet. How does this example demonstrate the foundations of free market economies?

The factors of production are labour, capital, entrepreneurs, natural resources, and information. All of these factors are relevant for Google (as they are for any business firm), but some are more prominently mentioned in the case study than others. The one that stands out most clearly is *entrepreneurship*. Without the entrepreneurial skills and interests of Brin and Page, Google would not be the successful business that it is. But as important as entrepreneurship has been in Google's success, we must remember that the other factors of production cannot be ignored. For example, *labour* is a key factor, and the case study mentions how Brin and Page have emphasized attracting talented, creative employees and providing them with a work environment and corporate culture that

fosters high productivity and high levels of innovation. *Capital* has also been important. After Brin and Page failed to find a buyer for their licensing idea, they had to raise capital so they could start their own firm. *Information* is a critical factor of production for a company like Google because that is the “commodity” that makes it a commercial success. *Natural resources* are not mentioned in the case, but these are obviously needed in all areas of Google’s operations. They include the land which Google uses for its facilities, as well as a wide variety of things like wood, steel, glass, minerals, chemicals and many other substances which are necessary in the production of the physical products and services that Google offers to consumers.

3. What role do governments play in the day-to-day operations of a company like Alphabet? Describe some of the ways governments can help this global organization as well as ways that governments may hurt this organization.

Chapter 1 provides a discussion of the many ways in which government influences business firms. Students should use that discussion as the basis for their answer to this question. They should, for example, explain that government may take on different roles, including that of a customer, a competitor, a regulator, a taxation agent, and a provider of incentives, financial assistance, and essential services. Some of these government roles impact a company like Google more than they do other companies. For example, governments have expressed the concern that Google’s market power may be excessive, and that its search engine may give some companies an advantages over their competitors because they are listed first when a search is conducted. This concern may or may not lead to legislation that could inhibit Google’s activities.

In the most general sense, governments help business firms (like Google) by providing an environment where business activity can flourish. Governments do this by taking on all of the roles noted above. For example, by providing highways, transportation of goods is facilitated. By providing statistical information, market research is facilitated. By providing incentives and financial assistance, governments can encourage new business formation.

All of the roles that government plays also have the potential for causing businesses problems. For example, taxation is always a controversial issue (for both consumers and for businesses). Everyone obviously wants to pay lower, rather than higher taxes, and conflict can develop as taxation levels are revised. The protection of consumers is another area where business owners may come into conflict with government. They may argue, for example, that government regulations are inhibiting their ability to run their business as they see fit. In almost any of their roles, government may be seen as not helping a company like Google. During the past decade, for example, Google has been criticized for manipulating search results, excessive energy consumption by its servers, using the intellectual property of others, avoiding taxes, and violating peoples’ privacy. Some of these concerns have come from consumers and some from government.