

# **CHAPTER 2**

## **THE ENVIRONMENT OF BUSINESS**

### **CHAPTER SYNOPSIS**

All businesses, regardless of their size, location, or mission, operate within a larger external environment. This external environment consists of everything outside an organization's boundaries that might affect it. The external environment plays a major role in determining the success or failure of any organization.

The economic environment refers to the conditions of the economic system in which an organization operates. The basic goals of an economic system are stability, full employment, and growth. Measures of how well an economy has accomplished these goals include gross national product, gross domestic product, productivity, balance of trade, and national debt. The Canadian government uses fiscal policies to manage the effects of its spending and revenue collection and monetary policies to control the size of the nation's money supply.

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 that are used to perform business activities.

The political-legal environment reflects the relationship between business and government, usually in the form of government regulation of business.

The socio-cultural environment includes the customs, mores, values, and demographic characteristics of the society in which an organization functions. Socio-cultural processes determine the goods and services as well as the standards of business conduct that a society is likely to value and accept.

Business today is faster paced, more complex, and more demanding than ever before. The challenges businesses face and their solutions make up the business environment.

Successful companies are responding to challenges in the external environment by redrawing traditional organizational boundaries. Major trends include acquisitions and mergers, divestitures and spinoffs, employee-owned corporations, strategic alliances, and subsidiary/parent corporations.

### **CHAPTER OUTLINE**

#### **I. ORGANIZATIONAL BOUNDARIES AND ENVIRONMENTS**

The external environment refers to everything outside an organization's boundaries that might affect it. Managers must have an accurate understanding of the external environment in which their company operates, as the environment has a significant impact on its success or failure.

A. **Organizational Boundaries**—These separate the organization from its environment. Today, boundaries are becoming increasingly complicated and difficult to identify, as interactions between businesses and suppliers alter traditional roles.

B. **Multiple Organizational Environments**—The external environment actually consists of many separate environments, including general and local economic conditions, technology, political-legal considerations, social issues, the global environment, issues of ethical and social responsibility, the business environment itself, and numerous other emerging challenges and opportunities.

## **II. THE ECONOMIC ENVIRONMENT**

The economic environment refers to the conditions of the economic system in which an organization operates. The three components of most concern are the rate of economic growth, level of unemployment and rate of inflation.

A. **Economic Growth**—More efficient use of resource, that is, greater output from the same inputs, or the same output with fewer inputs.

1. **Aggregate output and the standard of living**—Aggregate output refers to the total quantity of goods and services produced by an economic system during a given period. The standard of living refers to the quantity and quality of goods and services that a country's citizens can purchase with the currency used in their economic system

2. **The business cycle**—The growth and contraction pattern of short-term ups and downs in an economy.

3. **Gross Domestic Product (GDP) and Gross National Product (GNP)**—GDP is the total value of all goods and services produced within a given period by a national economy through domestic factors of production, regardless of who owns the factors of production. GNP is 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 rates**—The growth rate of GDP must be adjusted to remove the effects of inflation and changes in the value of the country's currency; this is the real growth rate of an economy. If the rate

of real growth of GDP exceeds the population growth rate, the standard of living improves.

b. GDP per capita—This is the GDP per person in a country. It is a better measure of the economic well being of the average person in the country than GDP.

c. Real GDP—Is calculated to remove the effects of changes in currency values and price changes. Nominal GDP is measured at current prices in current dollars.

d. Purchasing Power Parity—Allows a comparison of the standard of living in different countries.

4. Productivity—is a measure of economic growth that compares how much a system produces with the resources needed to produce it. Improved productivity allows more output with the same inputs. As supply increases, prices drop, consumers can purchase more, and the standard of living improves.

5. The balance of trade and the national debt—Several factors influence economic growth, including the balance of trade and the national debt.

a. The balance of trade—The balance of trade equals the economic value of all the products that a country exports minus the economic value of the products it imports. A negative balance of trade results when a country imports (what it buys from other countries) exceeds it exports (what it sells to other countries). A trade surplus (positive balance of trade) results when a country exports more than it imports.

b. National debt—A budget deficit occurs when government spending exceeds the revenues government takes in (primarily in the form of taxes). If accumulated spending exceeds revenues, the government borrows to make up the shortfall. A country's national debt is the amount of money that the government owes its creditors. In recent years, Canada has been the only highly industrialized country in the world that regularly reports budget surpluses. But now, even Canada is reporting budget deficits.

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

1. Inflation—Evident when widespread price increases occur throughout an economic system.

a. Measuring inflation: the CPI—The Consumer Price Index (CPI) measures the price of a basket of typical products purchased by consumers living in urban areas.

2. Deflation—A period of generally falling prices. Can result from reduced costs due to increased productivity (good) or because consumers have high debt loads and are unwilling to consume much (bad).

3. Unemployment—The level of joblessness among people actively seeking work in an economic system. There are four different types of unemployment: frictional, season, cyclical, and structural. Wage rates vary depending on the relationship between supply of and demand for labour.

C. Managing the Canadian Economy—Fiscal policies are government economic policies that determine how the government collects and spends its revenues. Monetary policies are government economic policies that determine the size of a nation's monetary supply, primarily through the Bank of Canada and management of the interest rate.

### **III. THE TECHNOLOGICAL ENVIRONMENT**

Technology has a variety of meanings, but as applied to the environment of business, it generally includes all the ways in which firms create value for their constituents.

A. Research and Development—Part of the innovation process that provides new ideas for products, services and processes. Pure research seeks new knowledge, without a particular product in mind. Applied research and development focuses on making the technological innovation into a commercial success. R & D spending in Canada makes up a lower proportion of GDP than in other countries, partly because many Canadian businesses are subsidiaries of U.S. companies and the research is being done in the U.S., not Canada. R& D intensity refers to R&D spending as a percentage of a company's sales revenue. Companies that select a competitive strategy that relies on being a leader in technology will have greater R&D intensity. It is a riskier strategy, but has the potential for significant rewards. Other companies do not want to create technological innovations, but prefer to compete on the basis of refining the

technology and finding a way to be the low-cost producer of the technology, which is less risky.

B. **Product and Service Technologies**—The technologies employed for creating products (both physical goods and services) for customers. Technology is important in manufacturing, but it is also a significant force in the service sector. The internet is a recent technological advance affecting all businesses. Businesses must be alert to new technologies with the potential to dramatically impact their operations. Innovative use of new technology can radically alter an industry and make an existing business or industry obsolete. The length of time it takes to accomplish a recurring activity from beginning to end is the cycle time. Reductions in cycle times reflect increased productivity and make the businesses more competitive. Technology transfer is the process of getting new technology out of the lab and used in practical applications in the marketplace.

#### **IV. THE POLITICAL-LEGAL ENVIRONMENT**

The relationship between business and government is important in Canada, since businesses are subject to government regulations. Pro- or anti-business sentiment in government can further influence business activity, whether on a federal, provincial or local level. Political stability is an important consideration, for firms interested in expanding internationally. Import and export opportunities may be affected by the relations between the Canadian government and the government of a potential trading partner.

#### **V. THE SOCIO-CULTURAL ENVIRONMENT**

The socio-cultural environment includes the customs, mores, values, and demographic characteristics of the society in which an organization functions.

A. **Customer Preferences and Tastes**—Customer preferences and tastes vary from one part of the country to another, and between different countries. Product usage also varies between countries, such as the marketing of bicycles as a recreational item in Canada and as a mode of transportation in many other countries. Consumer preferences and tastes change over time, with some changes driven by consumers and other driven by companies trying to increase sales. Finally, socio-cultural factors influence the standards of business conduct that are acceptable in the society, and the attitudes that workers in a society have towards their jobs and their employers.

B. **Ethical Compliance and Responsible Business Behaviour**—This is an especially critical element of the socio-cultural environment. The central issue is the failure of businesses to provide their stakeholders with a fair accounting of their financial health and competitive position. Another important issue is the determination of appropriate ethical behaviour when different ethical standards exist in different countries and Canadian companies are expected to participate in

behaviours that are acceptable in the foreign country but clearly unethical in a Canadian business setting.

## **VI. THE BUSINESS ENVIRONMENT**

The business environment includes expectations of customers, suppliers, shareholders, and employees. Current trends such as a more global economy are also an important element of the business environment.

A. The Industry Environment—Understanding the competitive environment in which a business operates is critical to developing a successful competitive strategy. One of the most popular tools for analyzing the competitiveness of the industry is Michael Porter’s five forces model. The stronger the forces, the more competitive the industry, and the more difficult it is for an individual company to operate profitably. If the forces are strong, the company normally has little ability to set its own selling prices and must be able to produce at a low cost to be profitable.

1. Rivalry among existing competitors—Can be seen in activities like intense price competition and elaborate advertising campaigns.
2. Threat of potential entrants—The lower the barriers to entry, the easier it is for new competitors to enter the market.
3. The bargaining power of suppliers—The existence of few suppliers limits the opportunities a company has to obtain the inputs it needs and provides the suppliers with strong bargaining power.
4. The bargaining power of customers—The existence of few customers when there are many suppliers provides the customers with strong bargaining power.
5. The existence of substitutes—If substitutes are readily available for the product a company sells, the industry is more competitive.

B. Emerging Challenges and Opportunities in the Business Environment—At present, companies are refocusing on their core competencies, those skills and resources with which they can gain a competitive advantage and create the most value for owners. Outsourcing activities that are outside their core competencies to businesses that do have the expertise needed can reduce the costs of performing those functions, but create dependencies on those suppliers.

1. Outsourcing—The strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or resources.

2. Social media and viral marketing—The strategy of using social media sites and word-of-mouth marketing to spread product information has become very important. By using various formats—games, contests, chat rooms, and bulletin boards—marketers encourage potential customers to try out products and tell other people about them.

3. Business Process Management—Creating team structures focused on processes rather than functional areas of business. By identifying those activities that are critical to the business' success, the processes that must be performed well to effectively carry out these activities, and then ensuring the necessary skills and resources are available, decision-making is faster and more customer-oriented, materials and production are better coordinated and products are delivered more rapidly.

## **VII. REDRAWING CORPORATE BOUNDARIES**

Companies are joining together in a variety of ways in order to take advantage of opportunities more effectively than is possible alone. Various methods have been used in recent years.

A. Acquisitions and Mergers—An acquisition is the purchase of another business, whereas a merger is a more collaborative process where two firms are consolidated into one. A horizontal merger means that two firms that have been direct competitors in the same industry now become one firm. A vertical merger is the joining together of two firms that had previously been in a customer-supplier relationship. A conglomerate merger occurs when two firms in completely different industries join together. A friendly takeover is an acquisition in which management of the acquired firm supports the change in ownership. A hostile takeover is an acquisition in which management of the acquired firm fights the attempt to acquire control. A poison pill is a defence that management adopts to make a firm less attractive in the event of an attempted hostile takeover.

B. Divestitures and Spinoffs—A divestiture is the sale of part of an existing business operation to another company. A spinoff is the strategy of setting up one or more corporate units as independent businesses, motivated by the belief that the units will be more valuable as a separate company.

C. Employee Owned Corporations—Employee stock ownership plans occur when corporations buy back their own shares on the stock market, and then transfer the stock to a trustee for the benefit of the employees, who then gain ownership of the stock through prearranged terms.

D. Strategic Alliances—The joining together of two or more companies on a temporary basis to undertake a particular project. Benefits include spreading the risk of the project between the allied businesses, and the sharing of expertise.

E. **Subsidiary and Parent Corporations**—A subsidiary corporation is one that is owned by another corporation (through the acquisition of more than 50% of the voting shares). A parent corporation is one that owns (or controls) the subsidiary.

### QUICK QUESTIONS

1. How will the various phases in the business cycle affect a small manufacturing firm?
2. How can economic growth be measured through aggregate output, standard of living, gross domestic product, and productivity?
3. How does the national debt affect economic growth?
4. Why have the items in the “basket of goods” making up the CPI changed over the years?
5. In what ways does the political-legal environment affect business activity?
6. In what ways does the socio-cultural environment affect business activity?
7. Explain how the factors in Porter’s Five Forces model are relevant to the competition between Chartered Accountants and Certified General Accountants.

### IN-CLASS EXERCISES

#### **Exercise #1: The Geography of Jobs**

##### **Activity Overview:**

This activity asks students to give some serious thought to the issue of outsourcing and its effect on the Canadian economy and on Canadian workers.

**Time Limit:** 30 minutes

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

1. Make sure that students are familiar with outsourcing before you conduct this exercise. Ask them to read the brief section on outsourcing in Chapter 2 in the text and the information found in italics below prior to the day when the exercise will be conducted. Make copies of the material in italics and hand it out to students in advance.

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#### *Outsourcing*

*Businesses are accountable to numerous external constituents. Also, managers sometimes have to optimize their decision making when dealing with conflicting interests. Nowhere is this more visible than in the current debate over the continued outsourcing of jobs to foreign employees.*

*Outsourcing is not a recent phenomenon. For years manufacturers have subcontracted their labor to low-cost factories in developing nations. Nike and Reebok, for instance, outsource the production of all their athletic shoes to factories in Southeast Asia. And many other companies have similar practices. In general, the jobs that have been outsourced have been relatively low-skill in nature. While labor and other observers have long been aware of this practice, business leaders have been able to argue with some conviction that this practice would lead to more high-quality jobs in places like the United States.*

*In recent years, a major change in outsourcing has occurred as more companies have started to outsource skilled and/or white-collar jobs to other countries. Companies like Microsoft find that highly skilled software programmers in places like India can perform as well as their U.S. counterparts for about a quarter of the salary costs. Boeing is now having some of its engineering work done abroad. And some experts are beginning to visualize how many other basic services, ranging from income tax preparation to financial analysis to medical records interpretation, can also be exported. How big is the problem? Experts project that 3.3 million jobs will be exported from the United States by 2015, and that another 14 million jobs have been identified as being “at risk.” Many experts also agree that while outsourcing may be bad for various specific individuals, in the long term it will be good for the country as a whole. And besides, as one CEO argues, “If your competitor is sending jobs overseas, you’re almost forced to do the same.”*

*That sentiment sums up the debate nicely. On the one hand, if businesses are accountable to their shareholders, they are obligated to keep their costs as low as possible and to remain competitive in their respective marketplaces. From this perspective, then, they should outsource whenever and wherever feasible. On the other hand, to the extent that businesses have a social obligation and an obligation to their current workers, they must take into account the social and human cost of displacing U.S. workers. So which side is right? This is a case in which there is no simple answer, and what is right or wrong is in the eye of the beholder.*

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2. Divide students into three- or four-member groups and ask them to discuss within their groups the pros and cons of (a) outsourcing in order to keep prices down, and (b) reducing dependence on outsourcing in order to better fulfill social obligations toward stakeholders. (15 minutes)

3. Reassemble the class and discuss each group’s opinions. (15 minutes)

**Don’t Forget:**

This is a case in which there is no simple answer!

**Wrap-Up:**

Wrap up the activity by reminding students that some industries may rely more heavily on outsourcing than others. Further, some industries gain higher-quality standards and

expertise through outsourcing. Also remind students of positive trade relationships that evolve through dependence on outsourcing.

### **Exercise #2: Experiential Exercise: Competing For Your Business**

#### **Activity Overview:**

The purpose of this exercise is to demonstrate the “invisible hand theory” by voting with your dollars.

**Time:** 50 minutes

#### **What To Do:**

1. Divide the class in half. Divide one half into teams of three or four students. Each team will be the owners of a video store. The other half of the class will act as customers (see below).
2. Each store will develop an offering they think is unique (20 minutes).
3. The group designated as customers should list their criteria for choosing a video store. (15 minutes)
4. The entrepreneurs will explain their store’s offering to the rest of the class who are potential customers (10 minutes).
5. Customers will line up in front of the store of their choice. Count the people in front of each store (5 minutes).

#### **Follow-up Questions:**

1. Is one store more popular than the others? Why is that?
2. What can the less-popular stores do to attract customers?
3. How would that affect the most-popular store?
4. Are the customers voting with their dollars?

### **Exercise #3: Corporate Reputations**

#### **Activity Overview:**

This activity is designed to help students assess the information in a case study, and then answer questions that are relevant to material presented in the chapter.

**Time Limit:** 25 minutes

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

1. Make copies of the case below and hand it out to students prior to the class when this exercise is to be conducted.

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*Case Study*  
*Corporate Reputations Are On The Line*

*During the last few years, there has been a great deal of negative publicity about business firms because of illegal and unethical behaviour by business executives and the economic woes that started in 2008. But some corporations continue to perform well, and to do good things for their stakeholders. Each year, the Reputation Institute publishes Global Pulse, which ranks the world's 1000 largest companies according to their reputation with their stakeholders. Each company's score is determined by how well it scores on key performance indicators like products/services, innovation, workplace, citizenship, governance, and leadership. In the 2008 survey, the top companies were Toyota (Japan), Google (United States), IKEA (Sweden), Ferrero (Italy), and Johnson & Johnson (United States). The highest ranked Canadian company was Jean Cotou Group, which ranked eighteenth.*

*A list of the most respected corporations in Canada is published by KPMG/Ipsos-Reid. Several hundred leading Canadian CEOs were asked to assess Canadian corporations on eight performance categories such as long-term investment value, innovation and product/service development, financial performance, corporate social responsibility, corporate governance, human resource management, and customer service. In one recent survey, the top-ranked companies were the Royal Bank of Canada, Research in Motion, EnCana Corp., and WestJet Airlines.*

*Surveys about corporate reputations are also conducted in the United States. The Reputation Quotient study is a joint effort of Harris Interactive Inc., a Rochester, New York-based research firm, and the Reputation Institute of New York. Its 2008 survey asked more than 20 000 people to name two companies with the best reputation and two companies with the worst reputation. Respondents evaluated the companies on factors such as emotional appeal, financial performance, social responsibility, vision and leadership, and workplace environment. In total, 60 companies were ranked. In the survey, 88 percent of respondents rated the reputation of American business as either "not good" or "terrible."*

*The company with the best reputation was Johnson & Johnson, a manufacturer of baby products and pharmaceuticals. The next four companies (in order) were Google, Sony Corporation, Coca-Cola, and Kraft Foods. Apparently, consumers have warm feelings about Johnson & Johnson because of its baby products.*

*The worst company was AIG, the recipient of a multi-billion dollar bailout by the U.S. government. General Motors, Chrysler, and Citigroup were also rated poorly. All of these companies received negative publicity in 2009 because of their financial problems.*

## Part 1—Introducing the Contemporary Business World

*It's not just individual companies that can run into difficulty, During the last few years, the reputations of entire industries have declined. For example, the reputations of the financial and automobile industries have declined sharply since the recession began in 2008. Consumer impressions of the pharmaceutical and oil industries are also negative because of a widely held belief that these industries are overcharging consumers for the products they sell. The tobacco industry has also had problems because consumers think that information about the negative effects of smoking and nicotine were withheld from the public.*

*When we consider negative information about business firms, we must remember that only a very small proportion of them are actually engaging in illegal or unethical behaviour. A review of the global, Canadian, and U.S. reputation lists—and the criteria that are used to generate them—provides some reassuring testimony on the vitality and values of many businesses. It also shows the manner in which they conduct their operations and gives us some insights into how companies must perform to gain the kind of stellar reputation necessary to get on the list.*

*These criteria all have one underlying theme: They reflect in one way or another the extent to which an organization and its managers effectively meet or exceed the needs and expectations of their external constituents. For example, hiring and developing the brightest and most motivated people from the labour market results in high levels of employee talent. Likewise, respecting the needs of shareholders and other investors affects several criteria, including financial soundness, use of corporate assets, and long-term investment value. Says one expert, “We admire companies that cater to their constituents.”*

### **Questions for Discussion**

1. What is your opinion of the value of the rankings like these? How might the different ways that the Canadian and U.S. surveys are conducted influence the results?
2. Do you think the criteria that are used are appropriate? Can you suggest others?
3. Is the ranking something that investors should rely on in buying stock?
4. If you were a top manager and wanted your firm to move up in the rankings, how would you proceed?

**Sources:** *The Reputation Institute, “Top 25 Reputation Leaders in the World,” [www.reputationinstitute.com/events/Global\\_Pulse\\_2008\\_Results.pdf](http://www.reputationinstitute.com/events/Global_Pulse_2008_Results.pdf), accessed May 6, 2009; [www.harrisinteractive.com](http://www.harrisinteractive.com), accessed May 4, 2009; Gordon Pitts, “The RBC Dynasty Continues,” *The Globe and Mail*, January 30, 2006, pp. B1, B10*

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2. Form three- or four-person groups and assign each group one of the questions for discussion found at the end of the case. Make sure all of the questions are covered. (10 minutes)

3. After the groups have completed their work, reassemble the class and discuss each question. (15 minutes)

**Don't Forget:**

Ask students during the discussion time whether managers should be concerned about ratings such as these, and whether there is any relationship between how well or poorly a company rates and how well or poorly the company does in the marketplace.

**Wrap-Up:**

Remind students that the corporate scandals of the past few years have received much publicity. Ask them whether they think this has reduced student interest in a career in business.

**Exercise #4: 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, restaurant).
3. Ask each group to consider what variables from the technological, political-legal, socio-cultural, 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.

**TEACHING TIPS**

*Part 1—Introducing the Contemporary Business World*

1. Before discussing the chapter material, ask students to form groups and define inflation, the national debt and budget deficits. Then have a general discussion to ensure that everyone understands these important fundamental concepts. Also, ask students why it is important to reduce the national debt and ask them to provide ideas for how this might be done.
2. Ask students to identify current events, court rulings, or legislation which present threats or opportunities for businesses. For example, what impact does a war have on business, and why? Emphasize how something as small as uncertainty can have a major impact.
3. Ask students to identify political events taking place in other countries and the potential impact that these events could have on Canadian businesses.
4. Ask students to identify current events or general conditions which may impact the success of a business today. List their answers on the board by organizational environments.
5. Have students form groups and discuss/list all the external factors (global, national, provincial or municipal) that have influenced specific businesses in their city of residence.
6. Ask students to describe their class. Identify the obvious demographic characteristics and also those factors, which may not be disclosed, such as, religion, sexual orientation, etc. Now speculate on how these factors might impact the decisions made by a business. Are there any opportunities? Threats?
7. Ask the students when a recession becomes a depression. Have them look up various downturns in the economy on the Internet. Many students may be surprised to hear that the Canadian economy has suffered more than one or two recessions over the last hundred years. Keep in mind there is no “official” benchmark on when a recession becomes a depression. Although the best answer may be from former U.S. president Harry Truman, who said: “It’s a recession when your neighbour loses his job; it’s a depression when you lose your own.”
8. Make sure that students understand that gross domestic product (GDP) 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.
9. Reinforce that gross national product (GNP) 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.
10. The following should generate a good discussion about productivity. A relevant example is typically helpful here. “If two student groups each produced a ten-page paper

by the end of the term, but one group had six members and the other group had three members, which group was more productive?” The answer often leads to a good discussion of the relationship between quality and productivity measures.

11. 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.
12. Have students look up Canada’s current balance of trade with various trading partners, including the U.S. Ask them about the importance of the American market. Do they see a need to diversify trading partners?
13. Ask students to identify technological innovations that have had a profound effect on an industry. There are a wide variety of examples from both the present and the past that may be discussed. Past innovations include the gas powered motor, which allowed for the development of the automobile and the decline in businesses which manufactured wagons and carts, harnesses, etc. This also led to the development of a network of service stations. If alternate fuel sources are successfully developed, what impact will that have on current industries? In the current environment, the development of internet capabilities has had a significant impact on many industries, including the music recording industry. What impact has the internet had on the sale of encyclopaedias?
14. Reinforce 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.
15. Ask students to describe the monetary policy currently in place in Canada. What does this indicate about the current state of the Canadian economy? What would be the expected change in interest rates if the government felt that the economy was slowing down and there was a strong possibility of a recession?
16. The recent trend of divestitures is in complete contrast to the policies of acquisition that characterized the 1980s. What factors might have led to this new trend?

### USING THE BOXED INSERTS

#### **Air Canada’s Challenging Environment: Competition, Economic Crisis, Fuel Prices, Volcanoes, and More**

The opening case provides information about Air Canada and describes several of the uncertainties that exist in its external environment. The uncertainties complicate strategic decision making by management of the company. Examples are provided demonstrating how environmental factors impact companies in the commercial airline business. These examples will help students understand the complexity of management decision making.

Questions for discussion/analysis include the following:

*Part 1—Introducing the Contemporary Business World*

1. Identify the various environmental factors which influence Air Canada. Which of these are most important? Explain.
2. How does the multi-year planning timeframe regarding the purchasing of aircraft impact management decisions?
3. How do unpredictable events impact Air Canada? Give examples.
4. What can Air Canada do to reduce the negative impact of environmental factors that complicate its activities?
5. How do government regulations of the commercial airline business affect Air Canada?

**The Greening of Business: The Hydrogen Fuel Cell**

The boxed insert describes the slow progress that has been evident with respect to getting the hydrogen fuel cell ready for the mass market. Despite its promise, the fuel cell still seems to be years away from truly widely commercial use. The daunting problems that are inhibiting rapid development of the fuel cell are noted in the insert.

**Critical Thinking Questions**

1. Review the section on new product development in Chapter 13. At what stage of the new product development process is the hydrogen fuel cell?

The hydrogen fuel cell is in the product testing and test marketing stage. There are limited numbers of both cars and buses which are powered by fuel cells, but as the case notes, the hydrogen fuel cell is nowhere near ready for the mass market. The fuel cell may be in this stage of the process for many years.

2. Consider the following statement: *“If the fuel cell had any value, it would have been fully developed by now and there would already be many cars on the road that are powered by the fuel cell.”* Do you agree or disagree with the statement? Explain your reasoning.

This statement is a useful starting point for a class debate on this issue. Students who agree with the statement will point to the hundreds of millions of dollars that have been spent so far, and will note that although many years have passed, the fuel cell is still stuck in the product testing stage. Other students will disagree with the statement and will point out that it can take many years for new product ideas to really catch on.

As part of the discussion, students should be encouraged to think of products that took many years to develop before they became successful, as well as products that after many years in development never quite made it to commercialization. They should then

think about the differences between these two classes of new products. The development of the automobile, radio, television, and computers are good examples of products that took a long time to develop but eventually became successful. The rotary engine is an example of a product that was in development many years, but never became widely adopted.

### **Entrepreneurship and New Ventures: Nova Scotia’s Golden Nectar**

Nova Scotia-based Glenora Distilleries has been battling to keep the term “Glen” in their brand name. The Scotch Whisky Association argues that the use of “Glen” in the brand is confusing consumers.

#### **Critical Thinking Question**

1. Which of the external environments have had the most effect on Glenora Distilleries?

The political-legal environment has had the biggest effect on Glenora Distilleries since it has had to fight legal battles about the right to name its products. Distillers in Scotland have been aggressively trying to protect the use of the word “scotch,” and have been quite successful. The economic environment has also affected Glenora since demand for various distilled products varies from place to place around the world.

### **E-Business and Social Media Solutions: Corus Entertainment Looking for Listeners and Revenues in New Places**

This boxed insert describes the rapid changes that have taken place in how consumers are using products like cameras, phones, and television in ways that they were not used just a few years ago. These changes in consumer consumption patterns have presented problems for traditional media outlets like radio stations, and they are looking for ways to attract new listeners by linking to Facebook, My Space, and YouTube. Developments at Corus Entertainment that are illustrative of new consumption patterns are described.

#### **Critical Thinking Question**

1. How do you listen to music? Have you joined or visited a social media group linked to your favourite stations? Why or why not?

The material presented in this boxed insert provides the starting point for an in-class discussion which should be very interesting to students because it raises issues of consumer consumption patterns that are understandable to students because they are important users of such services. It is best to identify several students ahead of time who have joined a social media group and ask them to describe their experiences. Students who have not joined such a group should also be asked why they have not do so. Differences in attitudes between the two groups can then be examined.

## QUESTIONS AND EXERCISES

### Questions for Analysis

1. It has been argued that inflation is both good and bad. How can this be? Explain. Are government efforts to control inflation well-advised? Explain.

Inflation is bad because it can lead to a spiral of rising wages chasing rising prices, which must rise to cover the cost of increased wages. It is good because it can signal the beginning of a period of growth for the economy. Government efforts are well advised as they try to control inflation by adjusting interest rates through monetary policy.

2. What are the benefits and risks of outsourcing? What, if anything, should be done about the problem of Canadian companies outsourcing for foreign countries? Defend your answer.

Benefits: saving costs, receiving independent know-how, avoiding idle capacity, availing of experts in a particular field, transferring operational responsibilities

Risks: relinquishing operational control, creating dependency, facing reliability issues, neglecting management supply chain

In terms of what, if anything should be done about outsourcing, answers will vary. The varying answers provide the instructor with an opportunity to lead a discussion that focuses on critical thinking about outsourcing. This would include analysis of unintended outcomes if some oversimplified solutions (for example, banning outsourcing) were attempted. It would also involve an analysis of whether certain assumptions are really reasonable (for example, it would seem that outsourcing increases unemployment, but does it also have other positive effects that might overwhelm reduced employment levels in the company that did the outsourcing?).

3. Why is it important for managers to understand the environment in which their businesses operate?

It is important because managers must develop strategies, schedule resources, assess capacity, improve production (performance), be competitive, and anticipate and handle problems. A lack of understanding about the environment makes good performance in these activities difficult to achieve.

4. Explain how current economic indicators such as inflation and unemployment affect you personally. Explain how they will affect you as a manager.

Inflation: Shows the increase in prices of products which impacts consumer purchasing power (CPI) and other personal aspects. It is also, to a certain extent, a gauge

of how well the overall economy evolves something that has a bearing on our personal lives as well.

**Unemployment:** Knowing how many people are out of work can provide you with an indication of the demand of certain skills, the state of employment benefits, the state of the economy (e.g., upswing, recession, depression), and how effectively government is managing the economy.

This question provides an opportunity to make the point that economic issues that may seem somewhat dry to students in the abstract become much more interesting when they are related to their own experiences. For example, students will be very interested in the amount of inflation that is evident with respect to increasing university tuition.

5. At first glance, it might seem as though the goals of economic growth and stability are inconsistent with one another. How can this apparent inconsistency be reconciled?

Answers will vary. The most general answer is that economic growth increases employment, output, and wealth creation, while stability sustains growth and reduces the threat of inflation.

6. What is the current climate in Canada regarding the regulation of business? How might it affect you if you were a manager today?

The recent corporate financial scandals and the fragile economy (as of 2010) have motivated the general public to call for increased government regulation of business and stricter enforcement of existing legislation. This increase in control measures will place additional constraints and burdens on management.

### **Application Exercises**

7. Select two businesses that you are familiar with. Identify the major elements of their external environments that are most likely to affect them in important and meaningful ways.

Answers will vary.

8. Assume that you are the owner of an internet pharmacy that sells prescription drugs to U.S. citizens. Analyze the factors in the external environment (economic, technological, political-legal, and socio-cultural) that might facilitate your company's activities. Analyze the factors in the external environment that might threaten your company's activities.

Answers will vary.

9. Select a technology product, such as Amazon’s Kindle e-reader, and research how the various environments of business (economic, technological, socio-cultural, global, political-legal, and general business) are currently impacting the sales possibilities of the product or service.

Answers will vary, but make sure that students systematically consider each of the external environments of business. While their emphasis may be on the technology environment, they must also consider the impact of the other environments. For example, high-tech gadgets may be made possible because of technological developments, but the level of consumer acceptance depends on socio-cultural factors.

10. Interview two business owners or managers. Ask them to answer the following questions: (a) what business functions, if any, they outsource; (b) are they focusing more attention on business process management now than in the past; (c) how have internet applications and the growth of social media changed the way they conduct business?

Answers will vary. To get a better idea of the pattern of answers, summarize the findings of individual class members for each of the three questions to determine what trends are evident in each area.

## **TEAM EXERCISES**

### **Building Your Business Skills: The Letdown from Environmental Upheaval**

#### **Follow-Up Questions**

1. What does this exercise demonstrate about the pitfalls of relying too heavily on one business?

“Don’t put all your eggs in one basket.” A business should strive to have more than one client, thus preventing a total dependence and its associated risks.

2. Could any of these businesses have been better prepared for the Enron collapse?

Again, “Don’t put all your eggs in one basket.” However, most would not have anticipated that such a major player as Enron would deliberately engage in criminal behaviour.

3. Managers must be on the alert for environmental changes that might negatively affect their business. Is it possible for a manager to spend too much time trying to anticipate future events? Why or why not?

Answers will vary. Anticipating and preparing for threats and opportunities arising from environmental change, is a primary responsibility of managers. Yet,

misguided planning can give rise to false hopes among employees and investors, and divert needed resources from other pertinent responsibilities.

### **Exercising Your Ethics: Team Exercise Finding The Balance**

#### **Activity Overview:**

This activity asks students to role-play and share their views on ethics in a real-world situation.

**Time Limit:** 35 minutes

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

1. Divide students into four-member teams and ask them to read and follow the instructions for the Exercising Your Ethics: Team Exercise found at the end of Chapter 2. Students should each choose one of the different roles in the exercise. (20 minutes)
2. Reassemble the class as a whole and discuss what disagreements came up within their groups. How did the role they played affect their perspective? (15 minutes)

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

Remind students that what one individual or group considers unethical may not be considered unethical by another individual or group.

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

Wrap up the activity by reminding students that striking the right ethical balance between an organization and employees can be difficult—there is much room for ethical ambiguity. And when other agents—customers, competitors, stockholders, suppliers, dealers, and unions—come into play, reaching an ethical balance is especially challenging. The right ethical balance involves creating a situation in which all parties involved can benefit in the best way possible.

## **CASE ANALYSIS**

### **Business Case 2: Inflation or Deflation?**

1. Based on your own observations in the marketplace, do you believe we are in an inflationary or deflationary period?

This is an opportunity to have students get some hands-on experience with the concept of inflation and inflation statistics. To adequately answer this question, students should choose a “basket” of products or services that they regularly purchase (or that they are knowledgeable about in terms of price). They should then determine the price of that basket for two time periods: 12 months ago and the present, and then calculate the percentage increase in the price of the basket that occurred over the 12 months. Ideally, they should use exact prices based on their own financial records, but even close approximations will give them a good idea of price changes.

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It is useful to have them make an estimate of inflation based on intuition before they begin their data analysis, and then compare their estimate with their actual calculation to see whether they under- or over-estimated the rate of inflation. Then ask why they think they under- or over-estimated the rate of inflation.

It is also useful to have them compare their own calculation about the rate of inflation with the Bank of Canada's published rates (see Question #2 below).

2. Go to the Bank of Canada website and find the latest inflation figures. Based on the latest statistics, is inflation or deflation a bigger problem today?

The case study makes the point that it is difficult to predict whether inflation or deflation will be the bigger problem in the future. At the time the students are taking their introduction to business course, have them go to the Bank of Canada website ([bankofcanada.ca](http://bankofcanada.ca)) and look for information about inflation. The website contains a substantial amount of information that should be of interest to students. On the home page, look at the “Key Indicators” heading at the top of the right side of the page. Then click on “Operational Guide,” which shows the core inflation rate for the most recent month.

Students can also scroll down to the bottom of that page and click on “Consumer Price Index” for more information about how inflation is measured. Students might find it interesting to use the “inflation calculator” to determine how inflation has varied over the years.

Two other questions that students might be asked regarding inflation are:

- a. What is the impact of excluding volatile elements like fuel, fresh fruit, natural gas, mortgage interest rates, etc.? Is it reasonable to exclude these items?
  - b. What is the difference between “core inflation” and “total inflation”?
3. What do you think of Phil Green's contention that the CPI has become a deceptive tool? Do you believe that governments are purposefully massaging the numbers? If so, explain why.

To answer this question, it is best if students read the article by Phil Green (“Hiding Inflation,” *National Post*, April 29, 2010, p. FP11). The main point that Green makes is that in recent years many countries have made substantial changes in the way they calculate inflation, and that those changes are leading to an understating of the rate of inflation compared to the way it used to be measured. In the U.S., for example, computing inflation using the old system yielded a 9.4 percent rate of inflation for February 2010, while government statistics showed that the rate was less than two percent.

Green also notes that at various times, governments ignore price changes in so-called “volatile” items on the grounds that rapid price changes in those items are not indicative of the “underlying” nature of prices. Taking out a lot of volatile products led to the development of the “core inflation” measure. But, of course, consumers are affected by the prices of volatile items, so critics argue that those should be included. Several interesting examples are provided in the article which will give students a much better understanding of what inflation is all about, as well as the fact that it can be a somewhat elusive number that is based on a lot of assumptions.

Have students visit the website “shadowstats.com” for additional information that questions the way that the U.S. government computes inflation. Since Canada uses some of the same techniques, questions can also be raised about Canadian inflation figures.

Some students will readily accept the claim that national governments are massaging the inflation data to make inflation look smaller than it really is. Students who take this position need to objectively address the issue of whether such things as core inflation vs. total inflation are reasonable concepts. There are other items mentioned in Green’s article that also need to be assessed (for example, the notion of increased quality in products and how to factor that into inflation figures).