

FIRST EDITION

ADVANCED BUSINESS FOUNDATIONS

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PART 1

Business in a Changing World

Chapter 1 The Dynamics of Business and Economics

Chapter 2 Business Ethics and Social Responsibility

Chapter 3 Business in a Borderless World

1

The Dynamics of Business and Economics



Chapter Outline

- › Introduction
- › The Nature of Business
 - The Goal of Business*
 - The People and Activities of Business*
 - Why Study Business?*
- › The Economic Foundations of Business
 - Economic Systems*
 - The Free-Enterprise System*
 - The Forces of Supply and Demand*
 - The Nature of Competition*
 - Economic Cycles and Productivity*
- › The American Economy
 - The Importance of the American Economy*
 - A Brief History of the American Economy*
 - Technology and the Economy*
 - The Role of the Entrepreneur*
 - The Role of Government in the American Economy*
 - The Role of Ethics and Social Responsibility in Business*
- › Can You Learn Business in a Classroom?

Learning Objectives

After reading this chapter, you will be able to:

- › LO 1-1 Define basic concepts such as business, product, profit, and economics.
- › LO 1-2 Identify the main participants and activities of business.
- › LO 1-3 Explain why studying business is important.
- › LO 1-4 Compare the four types of economic systems.
- › LO 1-5 Describe the role of supply, demand, and competition in a free-enterprise system.
- › LO 1-6 Specify why and how the health of the economy is measured.
- › LO 1-7 Outline the evolution of the American economy.
- › LO 1-8 Explain the role of the entrepreneur in the economy.
- › LO 1-9 Evaluate a small-business owner's situation and propose a course of action.

Enter the World of Business

Inside the Zoom Boom

Zoom, a video communications company, is a household name, but it wasn't always that way. Founded in 2011, Zoom entered the video conference technology market at a time when consumer and business demand was just starting to ramp up. It wasn't until the COVID-19 pandemic struck nearly a decade later that Zoom experienced an unprecedented surge in demand and became widely recognized as an industry leader.

Zoom enjoyed steady growth for years, with a \$9.2 billion valuation at the time of its 2019 initial public offering (IPO). Social distancing and isolation in 2020 fueled the demand for video communication and dramatically increased new Zoom user registrations. Zoom's user-friendly nature is one of the primary reasons the company emerged from the pandemic as one of the biggest corporate success stories. The platform is now worth close to \$100 billion.

The software company attracts many users to its free Basic account and attempts to convert these users into paying customers, a pricing model known as freemium pricing. Freemium pricing can be expensive for companies because it costs money to acquire new customers and to offer free access, making it especially painful when customers discontinue service after a free trial. Zoom, however, has experienced record profits and has signed on big-name clients.

Founder and CEO Eric Yuan set out to build a high-quality, easy-to-use video conferencing tool with modern features that would operate on slow internet connections. Yuan created a superior product that caters to the needs and wants of its customers, providing value and benefits. Zoom continues to be the video communications platform of choice for millions of users.^a

Critical Thinking Questions

1. How did the COVID-19 pandemic contribute to Zoom's success?
2. What value and benefits does Zoom offer?
3. What are the advantages of a freemium pricing model? Disadvantages?

Introduction

We begin our study of business in this chapter by examining the fundamentals of business and economics. First, we introduce the nature of business, including its goals, activities, and participants. Next, we describe the basics of economics and apply them to the U.S. economy. Finally, we establish a framework for studying business in this text.

LO 1-1

Define basic concepts such as business, product, profit, and economics.

business

individuals or organizations who try to earn a profit by providing products that satisfy people's needs.

product

a good or service with tangible and intangible characteristics that provide satisfaction and benefits.

profit

the difference between what it costs to make and sell a product and what a customer pays for it.

nonprofit organizations

organizations that may provide goods or services but do not have the fundamental purpose of earning profits.

The Nature of Business

A **business** produces products that satisfy people's needs to earn a profit. The outcomes of its efforts are **products** that have both tangible and intangible characteristics that provide value and benefits. When you purchase a product, you are buying the value and benefits you think the product will provide. A Subway sandwich, for example, may be purchased to satisfy hunger, while a Ford F-150 may be purchased to satisfy the need for transportation and the desire to present a certain image.

Most people associate the word *product* with tangible goods—an automobile, smartphone, jeans, or some other tangible item. However, a product can also be a service, which occurs when people or machines provide or process something of value to customers. Dry cleaning, a telemedicine visit, a movie or sports event—these are examples of services. An Uber ride satisfies the need for transportation and is, therefore, a service. A product can also be an idea. Accountants and attorneys, for example, provide ideas for solving problems.

The Goal of Business

The goal of business is to earn a **profit** while maintaining social responsibility. A profit is the difference between what it costs to make and sell a product and what a customer pays for it. In addition, a business has to pay for all expenses necessary to operate. If a company spends \$8 to produce, finance, promote, and distribute a product that it sells for \$10, the business earns a profit of \$2 on each product sold. Businesses have the right to keep and use their profits as they choose—within legal limits—because profit is the reward for their efforts and for the risks they take in providing products. Earning profits contributes to society by creating resources that support our social institutions and government. Businesses that create profits, pay taxes, and create jobs are the foundation of our economy. In addition, profits must be earned in an ethically and socially responsible manner. Most businesses give back to the community to support social and economic causes. Not all organizations are businesses, however. **Nonprofit organizations**—such as National Public Radio (NPR), Habitat for Humanity, and other charities and social causes—do not have the fundamental purpose of earning profits, although they may provide goods or services and engage in fund-raising. They also utilize skills related to management, marketing, and finance.

To earn a profit requires management skills to plan, organize, and control the activities of the business and to find and develop employees so that it can make products consumers will buy. A business also needs marketing expertise to learn what products consumers need and want and to develop, manufacture, price, promote, and distribute those products. Additionally, a business needs financial resources and skills

to fund, maintain, and expand its operations. A business must cover the cost of labor, operate facilities, pay taxes, and provide management. Other challenges for businesspeople include abiding by laws and government regulations and adapting to economic, technological, political, and social changes. Even nonprofit organizations engage in management, marketing, and finance activities to help reach their goals. Nonprofits also need employees with the same skills as businesses.

To achieve and maintain profitability, businesses have found that they must produce quality products, operate efficiently, and be socially responsible and ethical in dealing with customers, employees, investors, government regulators, and the community. Because these groups have a stake in the success and outcomes of a business, they are sometimes called **stakeholders**.

Many businesses, for example, are concerned about how the production and distribution of their products affect the environment. Automakers, for example, are working toward taking a bigger slice of the electric vehicle (EV) market. Other businesses are concerned with promoting science, engineering, and mathematics careers among women. Traditionally, these careers have been male-dominated. According to Bloomberg, when the number of men and women on a team are evenly matched, the companies have a higher return on equity.¹



Alex's Lemonade Stand Foundation is a nonprofit organization that raises funds and awareness for childhood cancer.

The People and Activities of Business

Figure 1.1 shows the people and activities involved in business. At the center of the figure are owners, employees, and customers; the outer circle includes the primary business activities—management, marketing, and finance. Owners have to put up resources, time, and effort, as well as financial and human resources, to start a business. Employees are responsible for the work that goes on within a business. Owners can manage the business themselves or hire employees to accomplish this task. The president and chief executive officer (CEO) of Procter & Gamble, David S. Taylor, does not own P&G but is an employee who is responsible for managing all the other employees in a way that earns a profit for investors, who are the real owners. Finally, and most importantly, a business's major role is to satisfy the customers who buy its goods or services. Note also that forces beyond an organization's control—such as legal and regulatory forces, the economy, competition, technology, the political environment, and ethical and social concerns—all have an impact on the daily operations of businesses. You will learn more about these participants in business activities throughout this book. Next, we will examine the major activities of business.

Management Notice that in Figure 1.1, management and employees are in the same segment of the circle. This is because management involves developing plans, coordinating employees' actions to achieve the firm's goals, organizing people to work efficiently, and motivating them to achieve the business's goals. Management

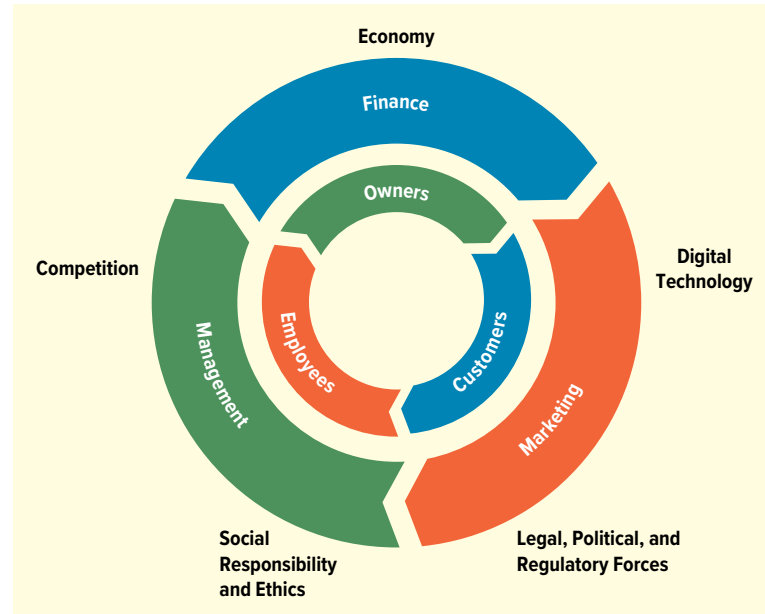
stakeholders

groups that have a stake in the success and outcomes of a business.

LO 1-2

Identify the main participants and activities of business.

FIGURE 1.1
Overview of the Business
World



involves the functions of planning, organizing, leading, and controlling. Effective managers who are skilled in these functions display effective leadership, decision making, and delegation of work tasks. According to Jeff Bezos, founder and former CEO of Amazon, a key to effective management is to make a small number of high-quality decisions and delegate day-to-day business operations decisions.² Management is also concerned with acquiring, developing, and using resources (including people) effectively and efficiently.

Management involves organization, teamwork, and communication. Operations and supply chain management are also important. Motivating the workforce and managing human resources are necessary for success. Managers at the Ritz-Carlton, for instance, are concerned with transforming resources such as employee actions and hotel amenities into a quality customer service experience. In essence, managers plan, organize, staff, and control the tasks required to carry out the work of the company or nonprofit organization. We take a closer look at management activities in Parts 3 and 4 of this text.

Marketing Marketing and customers are in the same segment of Figure 1.1 because the focus of all marketing activities is satisfying customers. Marketing includes all the activities designed to provide goods and services that satisfy consumers' needs and wants. Marketers gather information and conduct research to determine what customers want. Using information gathered from marketing research, marketers plan and develop products and make decisions about how much to charge for their products and when and where to make them available. They also analyze the marketing environment to understand changes in competition and consumers. The retail environment is changing based on competition from online retailing. This has caused many retail stores and malls to close.³ Marketing focuses on the four P's—product, price, place (or distribution), and promotion—also known as the marketing mix. Product management involves key management decisions such as product adoption, development, branding, and product positioning. Selecting the right price for the product is essential

to the organization as it relates directly to profitability. Distribution (or place) is an important management concern because it involves making sure products are available to consumers in the right place at the right time. Marketers use promotion—advertising, personal selling, sales promotion (coupons, games, sweepstakes, movie tie-ins), and publicity—to communicate the benefits and advantages of their products to consumers and to increase sales. For example, Stevia in the Raw uses advertising as part of its promotion mix to appeal to consumers who enjoy sweets but want a healthier alternative to sugar. In the advertisement, Stevia in the Raw communicates that its product, a zero-calorie sweetener, reduces sugar and calories for a more healthful recipe. We will examine marketing activities in Part 5 of this text.

Finance Owners and finance are adjacent in Figure 1.1 because, although management and marketing have to deal with financial considerations, it is the primary responsibility of the owners to provide financial resources for the operation of the business. Accounting, money, and the financial system, as well as understanding the securities market, are important for business success. People who work as accountants, financial analysts, investment advisors, or bankers are all part of the financial world. Owners have to rely on investors and loans from financial institutions and often issue stocks or bonds to have financial resources. Owners of small businesses in particular often rely on bank loans for funding. Part 6 of this text discusses financial management.



Advertising is one method for marketers to promote the benefits and advantages of their products. This advertisement features Stevia in the Raw, a sugar alternative, and instructs consumers on how to make cake with half the sugar and calories.

Source: Stevia in the Raw

Why Study Business?

Studying business can help you develop skills and acquire knowledge to prepare for your future career, regardless of whether you plan to work for a large corporation, start your own business, work for a government agency, or manage or volunteer at a nonprofit organization. The field of business offers a variety of interesting and challenging career opportunities throughout the world, such as marketing, human resources management, information technology, finance, production, accounting, data analytics, and many more.

Studying business can also help you better understand the many business activities that are necessary to provide satisfying goods and services. Most businesses charge a reasonable price for their products to ensure that they cover their production costs, pay their employees, provide their owners with a return on their investment, and perhaps give something back to their local communities and societies. The Home Depot Foundation has provided grants to remodel and renovate homes of U.S. military veterans.⁴ Thus, learning about business can help you become a well-informed consumer and member of society.

LO 1-3

Explain why studying business is important.



The Home Depot Foundation's Veteran Housing Grants Program awards grants to assist in the construction of housing and facilities for veterans.

LO 1-4

Compare the four types of economic systems.

economics
the study of how resources are distributed for the production of goods and services within a social system.

natural resources
land, forests, minerals, water, and other things that are not made by people.

human resources (labor)
the physical and mental abilities that people use to produce goods and services.

financial resources (capital)
the funds used to acquire the natural and human resources needed to provide products.

economic system
a description of how a particular society distributes its resources to produce goods and services.

Business activities help generate not only the profits that are essential to individual businesses and local economies, but also the products that provide quality of life for the public. Understanding how our free-enterprise economic system allocates resources and provides incentives for industry and the workplace is important to everyone.

The Economic Foundations of Business

It is useful to explore the economic environment in which business is conducted. In this section, we examine economic systems, the free-enterprise system, the concepts of supply and demand, and the role of competition. These concepts play important roles in determining how businesses operate in a particular society.

Economics is the study of how resources are distributed for the production of goods and

services within a social system. You are already familiar with the types of resources available. Land, forests, minerals, water, and other things that are not made by people are **natural resources**. **Human resources**, or **labor**, refer to the physical and mental abilities that people use to produce goods and services. **Financial resources**, or **capital**, are the funds used to acquire the natural and human resources needed to provide products. These resources are related to the *factors of production*, consisting of land, labor, capital, and enterprise used to produce goods and services. The firm can also have intangible resources such as a good reputation for quality products or being socially responsible. The goal is to turn the factors of production and intangible resources into a competitive advantage.

Economic Systems

An **economic system** describes how a particular society distributes its resources to produce goods and services. A central issue of economics is how to fulfill an unlimited demand for goods and services in a world with a limited supply of resources. Different economic systems attempt to resolve this central issue in numerous ways.

Although economic systems handle the distribution of resources in different ways, all economic systems must address three important issues:

1. What goods and services, and how much of each, will satisfy consumer needs?
2. How will goods and services be produced, who will produce them, and with what resources will they be produced?
3. How are the goods and services to be distributed to consumers?

Communism, socialism, and capitalism, the basic economic systems found in the world today (Table 1.1), have fundamental differences in the way they address these issues. The factors of production in command economies are controlled by government planning. In many cases, the government owns or controls the production of goods and services. Communism and socialism are, therefore, considered command economies.

TABLE 1.1 Comparison of Communism, Socialism, and Capitalism

	Communism	Socialism	Capitalism
Business ownership	Most businesses are owned and operated by the government.	The government owns and operates some basic industries; individuals also own businesses.	Individuals own and operate all businesses.
Competition	Government controls competition and the economy.	Restricted in basic industries; encouraged in other businesses.	Encouraged by market forces and government regulations.
Profits	Excess income goes to the government. The government supports social and economic institutions.	Profits earned by businesses may be reinvested in the business; profits from government-owned industries go to the government.	Individuals and businesses are free to keep profits after paying taxes.
Product availability and price	Consumers have a limited choice of goods and services; prices are usually high.	Consumers have a choice of goods and services; prices are determined by supply and demand.	Consumers have a wide choice of goods and services; prices are determined by supply and demand.
Employment options	Little choice in choosing a career; most people work for government-owned industries or farms.	More choice of careers; many people work in government jobs.	Unlimited choice of careers.

Communism Karl Marx (1818–1883) first described **communism** as a society in which the people, without regard to class, own all the nation's resources. In his ideal political-economic system, everyone contributes according to ability and receives benefits according to need. In a communist economy, the people (through the government) own and operate all businesses and factors of production. Central government planning determines what goods and services satisfy citizens' needs, how the goods and services are produced, and how they are distributed. However, no true communist economy exists today that satisfies Marx's ideal.

On paper, communism appears to be efficient and equitable, producing less of a gap between rich and poor. In practice, however, communist economies have been marked by low standards of living, critical shortages of consumer goods, high prices, corruption, and little freedom. Russia, Poland, Hungary, and other eastern European nations have turned away from communism and toward economic systems governed by supply and demand rather than by central planning. However, their experiments with alternative economic systems have been fraught with difficulty and hardship. Countries such as Venezuela have tried to incorporate communist economic principles without success. Even Cuba is experiencing changes to its predominately communist system. Similarly, China was the first communist country to make strong economic gains by adopting capitalist approaches to business. Economic prosperity has advanced in China with the government claiming to ensure market openness, equality, and fairness through state capitalism.⁵ As a result of economic challenges, communism is declining and its future as an economic system is uncertain.

Socialism **Socialism** is an economic system in which the government owns and operates basic industries—postal service, telephone, utilities, transportation, health care, banking, and some manufacturing—but individuals own most businesses. For example, in France the postal service industry La Poste is 74 percent owned by the French government and makes a profit. Central planning determines what basic goods

communism first described by Karl Marx as a society in which the people, without regard to class, own all the nation's resources.

socialism an economic system in which the government owns and operates basic industries, but individuals own most businesses.

Cuba's new constitution promotes socialism rather than communism.



and services are produced, how they are produced, and how they are distributed. Individuals and small businesses provide other goods and services based on consumer demand and the availability of resources. Citizens are dependent on the government for many social services, such as education, health care, and subsidized housing.

Most socialist nations, such as Norway, India, and Israel, are democratic and recognize basic individual freedoms. Citizens can vote for political offices, but central government planners usually make many decisions about what is best for the nation. Low-income individuals in Norway can apply for a housing allowance grant in order to pay for housing of a good standard, as determined by the government.⁶ People are free to go into the occupation of their choice, but they often work in government-operated organizations. Socialists believe their system permits a higher standard of living than other economic systems, but the difference often applies to the nation as a whole rather than to its individual citizens. Socialist economies profess egalitarianism—equal distribution of income and social services. They believe their economies are more stable than those of other nations. Although this may be true, taxes and unemployment are generally higher in socialist countries. However, countries like Finland, which is rated as the world's happiest country, have a high standard of living.

capitalism (free enterprise)

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

free-market system

pure capitalism, in which all economic decisions are made without government intervention.

Capitalism Capitalism, or **free enterprise**, is an economic system in which individuals own and operate the majority of businesses that provide goods and services. Competition, supply, and demand determine which goods and services are produced, how they are produced, and how they are distributed. The United States, Canada, Japan, and Australia are examples of economic systems based on capitalism.

There are two forms of capitalism: pure capitalism and modified capitalism. In pure capitalism, also called a **free-market system**, all economic decisions are made without government intervention. This economic system was first described by Adam Smith in *The Wealth of Nations* (1776). Smith, often called the father of capitalism, believed that the “invisible hand of competition” best regulates the economy. He argued that competition should determine what goods and services people need. Smith’s system is

also called *laissez-faire* (“let it be”) *capitalism* because the government does not interfere in business. But Smith believed the system required ethical and socially responsible conduct.

Modified capitalism differs from pure capitalism in that the government intervenes and regulates business to some extent. One of the ways in which the United States and Canadian governments regulate business is through laws. Laws such as the Federal Trade Commission Act, which created the Federal Trade Commission to enforce fair competition and consumer protection, illustrate the importance of the government’s role in the economy. In the United States, states have leeway to regulate business. For example, the state of California requires public companies to have at least one woman on the board of directors, and a number of states have legalized cannabis.⁷

Mixed Economies No country practices a pure form of communism, socialism, or capitalism, although most tend to favor one system over the others. Most nations operate as **mixed economies**, which have elements from more than one economic system. In socialist Sweden, most businesses are owned and operated by private individuals. In capitalist United States, an independent federal agency operates the postal service and another independent agency operates the Tennessee Valley Authority, an electric utility. In Germany, the Deutsche Post is privatized and trades on the stock market. In once-communist Russia, Hungary, Poland, and other eastern European nations, capitalist ideas have been implemented, including private ownership of businesses.

mixed economies
economies made up of
elements from more than one
economic system.

Countries such as China and Russia have used state capitalism to advance the economy. State capitalism tries to integrate the powers of the state with the advantages of capitalism. It is led by the government but uses capitalistic tools such as listing state-owned companies on the stock market and embracing globalization.⁸ State capitalism includes some of the world’s largest companies such as Russia’s Gazprom, which has the largest reserves of natural gas. Years ago, China’s largest companies were previously all state-owned, but today the country’s leaders are Alibaba, an e-commerce giant, and Tencent, a multinational technology company.⁹

The Free-Enterprise System

Many economies—including those of the United States, Canada, and Japan—are based on free enterprise, and many communist and socialist countries, such as China and Russia, are applying more principles of free enterprise to their own economic systems. Free enterprise provides an opportunity for a business to succeed or fail on the basis of market demand. In a free-enterprise system, companies that can efficiently manufacture and sell products that consumers desire will probably succeed. Inefficient businesses and those that sell products that do not offer needed benefits will likely fail as consumers take their business to firms that have more competitive products.

A number of basic individual and business rights must exist for free enterprise to work. These rights are the goals of many countries that have recently embraced free enterprise.

1. Individuals must have the right to own property and to pass this property on to their heirs. This right motivates people to work hard and save to buy property.
2. Individuals and businesses must have the right to earn profits and to use the profits as they wish, within the constraints of their society’s laws, principles, and values.

3. Individuals and businesses must have the right to make decisions that determine the way the business operates. Although there is government regulation, the philosophy in countries like the United States and Australia is to permit maximum freedom within a set of rules of fairness.
4. Individuals must have the right to choose what career to pursue, where to live, what goods and services to purchase, and more. Businesses must have the right to choose where to locate, what goods and services to produce, what resources to use in the production process, and so on.

Without these rights, businesses cannot function effectively because they are not motivated to succeed. Thus, these rights make possible the open exchange of goods and services. In the countries that favor free enterprise, such as the United States, citizens have the freedom to make many decisions about the employment they choose and create their own productivity systems. Many entrepreneurs are more productive in free-enterprise societies because personal and financial incentives are available that can aid in entrepreneurial success. For many entrepreneurs, their work becomes a part of their system of goals, values, and lifestyle. Consider the panelists (“sharks”) on the ABC program *Shark Tank* who give entrepreneurs a chance to receive funding to realize their dreams by deciding whether to invest in their projects. They include Barbara Corcoran, who built one of New York’s largest real estate companies; Mark Cuban, founder of MicroSolutions and Broadcast.com; and Daymond John, founder of clothing company FUBU, as well as others.¹⁰

demand

the number of goods and services that consumers are willing to buy at different prices at a specific time.

supply

the number of products—goods and services—that businesses are willing to sell at different prices at a specific time.

LO 1-5

Describe the role of supply, demand, and competition in a free-enterprise system.

The Forces of Supply and Demand

In the United States and in other free-enterprise systems, the distribution of resources and products is determined by supply and demand. **Demand** is the number of goods and services that consumers are willing to buy at different prices at a specific time.

From your own experience, you probably recognize that consumers are usually willing to buy more of an item as its price falls because they want to save money. Consider handmade rugs, for example. Consumers may be willing to buy six rugs at \$350 each, four at \$500 each, but only two at \$650 each. The relationship between the price and the number of rugs consumers are willing to buy can be shown graphically with a *demand curve* (see Figure 1.2).

Supply is the number of products that businesses are willing to sell at different prices at a specific time. In general, because the potential for profits is higher, businesses are willing to supply more of a good or service at higher prices. For example, a company that sells rugs may be willing to sell six at \$650 each, four at \$500 each, but just two at \$350 each. The relationship between the price of rugs and the quantity the company is willing to supply can be shown graphically with a *supply curve* (see Figure 1.2).

In Figure 1.2, the supply and demand curves intersect at the point where supply and demand



Oprah Winfrey, with a net worth of nearly \$3 billion, is one of the world’s most famous entrepreneurs. Entrepreneurs are more productive in free-enterprise systems.



Responding to Business Challenges

Taylor Swift Fights Scalpers

For fans of popular singers like Taylor Swift, the demand for concert tickets is high. Fans must often hurry to purchase tickets before they are sold out. Because there are a limited number of seats, when demand is high, the equilibrium price is high as well. While this is profitable for the performer, it also creates opportunities for ticket scalpers.

Because of high demand for certain performers and a limited supply of seats, scalpers know there is a market of fans willing to pay much more than the original price online. This gives them opportunities to purchase large numbers of tickets and sell at a premium on sites like Stub Hub. It is estimated that ticket scalping cost Taylor Swift \$85 million during one tour.

Two scalpers in the United Kingdom used bot software and multiple identities to illegally buy and sell tickets, making more than £10.8 million (\$14 million). The duo received a collective jail sentence of six and half years from a U.K. court. It was a landmark ruling as it was the first prosecution of its kind in the United Kingdom. As technology advances, it becomes increasingly difficult to fend off cybercriminals.

To fight against scalpers, Swift joined with Ticketmaster to use its Verified Fan system to locate fans less likely to resell their tickets. Fans register and—if they are identified by Ticketmaster's Verified Fan system—they are sent a link that gives them early access to tickets. Swift also added boosters to the system, giving fans a better chance of being selected if they buy albums, watch music videos, or post about her on social media. The system offers a solution to reward fans and fight against a practice that takes advantage of high demand and limited supply.^b

Critical Thinking Questions

1. Describe how the supply-demand problem is offering opportunities for scalpers.
2. Scalpers raise the equilibrium price once they control the supply. How do you think this Ticketmaster Verified Fan system will affect this ability?
3. As a service provider, do you think performers like Taylor Swift should take an active role in fighting against scalpers? Why or why not?

are equal. The price at which the number of products that businesses are willing to supply equals the amount of products that consumers are willing to buy at a specific point in time is the **equilibrium price**. In our rug example, the company is willing to supply four rugs at \$500 each, and consumers are willing to buy four rugs at \$500 each. Therefore, \$500 is the equilibrium price for a rug at that point in time, and most rug companies will price their rugs at \$500. As you might imagine, a business that charges more than \$500 (or whatever the current equilibrium price is) for its rugs will not sell

equilibrium price
the price at which the number of products that businesses are willing to supply equals the amount of products that consumers are willing to buy at a specific point in time.

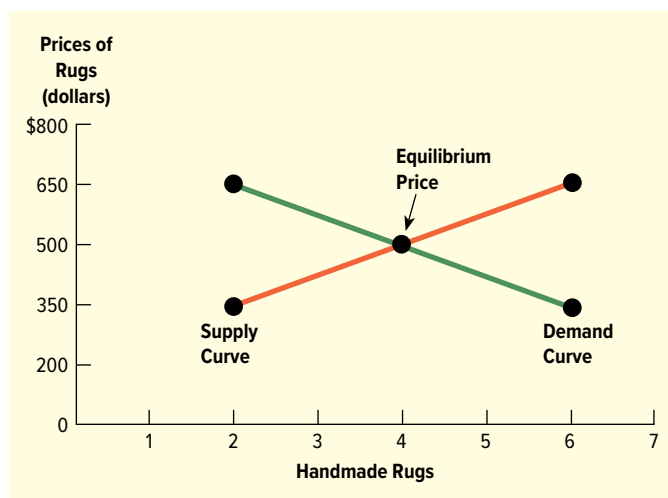


FIGURE 1.2
Equilibrium Price of Handmade Rugs

as many and might not earn a profit. On the other hand, a business that charges less than \$500 accepts a lower profit per rug than could be made at the equilibrium price.

If the cost of making rugs goes up, businesses will not offer as many at the old price. Changing the price alters the supply curve, and a new equilibrium price results. This is an ongoing process, with supply and demand constantly changing in response to changes in economic conditions, availability of resources, and degree of competition. For example, the price of oil can change rapidly and has been between \$0 and \$113 a barrel over the last 10 years. Oil prices dropped below \$0 when demand went down rapidly and supply increased during the COVID-19 pandemic. Oil prices returned to normal when supply and demand were more balanced. Prices for goods and services vary according to these changes in supply and demand. Supply and demand are the forces that drive the distribution of resources (goods and services, labor, and money) in a free-enterprise economy.

Critics of supply and demand say the system does not distribute resources equally. The forces of supply and demand prevent sellers who have to sell at higher prices (because their costs are high) and buyers who cannot afford to buy goods at the equilibrium price from participating in the market. According to critics, the wealthy can afford to buy more than they need, but the poor may be unable to buy enough of what they need to survive.

The Nature of Competition

competition
the rivalry among businesses for consumers' dollars.

Competition, the rivalry among businesses for consumers' dollars, is another vital element in free enterprise. According to Adam Smith, competition fosters efficiency and low prices by forcing producers to offer the best products at the most reasonable price; those who fail to do so are not able to stay in business. Thus, competition should improve the quality of the goods and services available and reduce prices. Competition allows for open markets and provides opportunities for both individuals and businesses to successfully compete. Entrepreneurs can discover new technology, ways to lower prices, as well as methods for providing better distribution or services. Elon Musk (Tesla), Richard Branson (Virgin Group), and Jeff Bezos (Amazon) are prime examples. Together, their aerospace companies, SpaceX, Virgin Galactic, and Blue Origin, have turned space tourism into a reality.¹¹

Within a free-enterprise system, there are four types of competitive environments: pure competition, monopolistic competition, oligopoly, and monopoly.

pure competition
the market structure that exists when there are many small businesses selling one standardized product.

Pure competition exists when there are many small businesses selling one standardized product, such as agricultural commodities like wheat, corn, and cotton. No one business sells enough of the product to influence the product's price. And, because there is no difference in the products, prices are determined solely by the forces of supply and demand.

monopolistic competition
the market structure that exists when there are fewer businesses than in a pure-competition environment and the differences among the goods they sell are small.

Monopolistic competition exists when there are fewer businesses than in a pure-competition environment and the differences among the goods they sell are small. Aspirin, soft drinks, and jeans are examples of such goods. These products differ slightly in packaging, warranty, name, and other characteristics, but all satisfy the same consumer need. Businesses have some power over the price they charge in monopolistic competition because they can make consumers aware of product differences through advertising. Consumers value some features more than others and are often willing to pay higher prices for a product with the features they want. For example, the Dyson Supersonic Hair Dryer costs \$400 and offers different features and benefits than other hair dryers.

An **oligopoly** exists when there are very few businesses selling a product. In an oligopoly, individual businesses have control over their products' prices because each business supplies a large portion of the products sold in the marketplace. Nonetheless, the prices charged by different firms stay fairly close because a price cut or increase by one company will trigger a similar response from another company. In the airline industry, for example, when one airline cuts fares to boost sales, other airlines quickly follow with rate decreases to remain competitive. On the other hand, airlines often raise prices at the same time. Oligopolies exist when it is expensive for new firms to enter the marketplace. Not just anyone can acquire enough financial capital to build an automobile production facility or purchase enough airplanes and related resources to build an airline.

oligopoly

the market structure that exists when there are very few businesses selling a product.

When there is one business providing a product in a given market, a **monopoly** exists. Utility companies that supply electricity, natural gas, and water are monopolies. The government permits such monopolies because the cost of creating the good or supplying the service is so great that new producers cannot compete for sales. Government-granted monopolies are subject to government-regulated prices. Some monopolies exist because of technological developments that are protected by patent laws. This monopoly allows the developer to recover research, development, and production expenses and to earn a reasonable profit. A drug can receive a 17-year patent from the time it is discovered or the chemical is identified. For example, Tamiflu lost its patent, and now the generic version can be made by other firms.

monopoly

the market structure that exists when there is only one business providing a product in a given market.

Economic Cycles and Productivity

Expansion and Contraction Economies are not stagnant; they expand and contract. **Economic expansion** occurs when an economy is growing and people are spending more money. Their purchases stimulate the production of goods and services, which in turn stimulates employment. The standard of living rises because more people are employed and have money to spend. Rapid expansions of the economy, however, may result in **inflation**, a continuing rise in prices. Inflation can be harmful if individuals' incomes do not increase at the same pace as rising prices, reducing their buying power. Venezuela's inflation was 6,500 percent in 2021. By comparison, inflation in the United States was 2.8 percent at the same time.¹²

economic expansion

the situation that occurs when an economy is growing and people are spending more money; their purchases stimulate the production of goods and services, which in turn stimulates employment.

Economic contraction occurs when spending declines. Businesses cut back on production and lay off workers, and the economy as a whole slows down. Contractions of the economy lead to **recession**—a decline in production, employment, and income. Recessions are often characterized by rising levels of **unemployment**, which is measured as the percentage of the population that wants to work but is unable to find jobs. Figure 1.3 shows the overall unemployment rate in the civilian labor force over the past 80 years. Rising unemployment levels tend to stifle demand for goods and services, which can have the effect of forcing prices downward, a condition known as **deflation**. Deflation poses a serious economic problem because price decreases could result in consumers delaying purchases. If consumers wait for lower prices, the economy could fall into a recession.

inflation

a condition characterized by a continuing rise in prices.

economic contraction

a slowdown of the economy characterized by a decline in spending and during which businesses cut back on production and lay off workers.

recession

a decline in production, employment, and income.

unemployment

the condition in which a percentage of the population wants to work but is unable to find jobs.

The United States has experienced numerous recessions, the most recent ones occurring in 1990–1991, 2002–2003, 2008–2011, and 2020. The Great Recession of 2008–2011 was caused by the collapse in housing prices and consumers' inability to stay current on their mortgage and credit card payments. This caused a crisis in the banking industry, with the government bailing out banks to keep them from failing. This, in turn, caused a slowdown in spending on consumer goods and a decrease in



Business Disruption

Competition Is Brewing in Kombucha Market

Kombucha might be fizzy like a soft drink, but it has health benefits that soft drinks lack. Kombucha is made by brewing tea, then adding sugar. Afterward, the mixture is fermented with a blend of yeast and bacteria called scoby. The bacteria the drink contains make kombucha a probiotic that helps digestion and gut health. Scoby cultures can produce an endless supply of kombucha, reducing waste and enabling consumers to brew kombucha in their homes.

Kombucha manufacturers operate in a monopolistic competitive industry. Because kombucha is relatively easy to produce, manufacturers take steps to differentiate their products, such as developing drinks in a variety of unique, fruity flavors. With consumer interest in the beverage skyrocketing, the demand is encouraging the entrance of new competitors.

PepsiCo spent around \$200 million to acquire KeVita, and Coca-Cola has a stake in Health-Ade. Starbucks has its own

line of kombucha under its Evolution Fresh brand. These steps are prompting traditional kombucha manufacturers to become more competitive. For instance, Brew Dr., one of the leading kombucha brands, has advertised its drinks with Portland's soccer teams to increase awareness.

Analysts have compared kombucha to yogurt not only for its probiotic qualities, but for its market qualities. The industry is expected to grow and diversify in the future. The competition between smaller kombucha manufacturers and more established rivals is heating up.^c

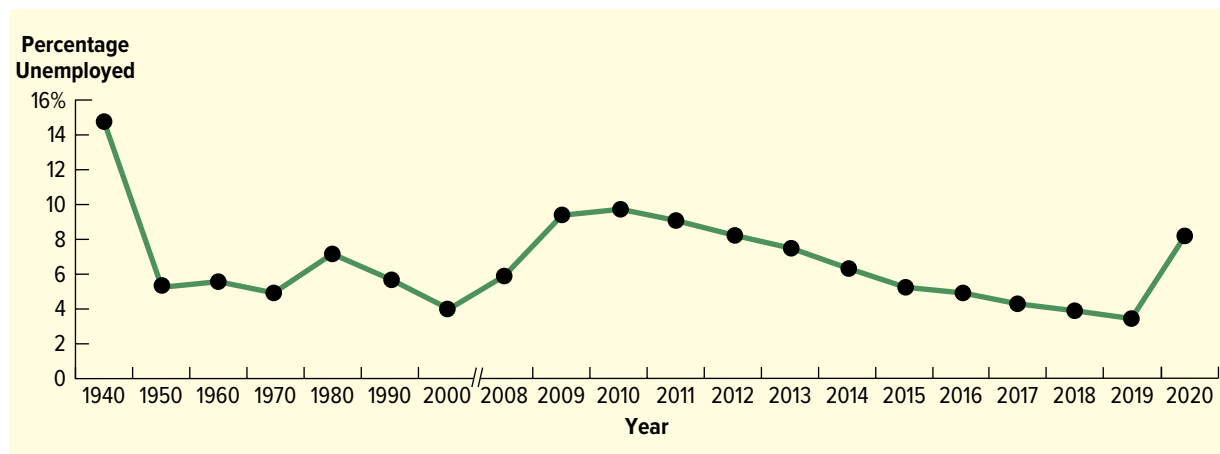
Critical Thinking Questions

1. Why is the competition in the kombucha industry an example of monopolistic competition?
2. How are the forces of supply and demand convincing more established brands like PepsiCo to enter the industry?
3. If more and more entrants enter the industry, what do you think will happen to the price of kombucha?

employment. Unemployment reached 10 percent of the labor force. Ten years later, unemployment was nearing a 50-year low, but during the COVID-19 (coronavirus) pandemic, the unemployment rate skyrocketed to a record 14.7 percent in 2020, the worst since the Great Depression.¹³ As Americans were urged to stay home to prevent the spread of the virus, nonessential businesses—such as clothing stores, gyms, and salons—shuttered, and many were forced to lay off employees. Even restaurants, many

FIGURE 1.3

Annual Average Unemployment Rate, Civilian Labor Force, 16 Years and Over



Source: Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey," <http://data.bls.gov/timeseries/LNSI4000000> (accessed July 20, 2021).

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of which remained open for pickup and delivery, suffered greatly. Though online and nonstore sales were up 21.2 percent year over year, overall retail sales were down 21.6 percent, according to the U.S. Census Bureau.¹⁴ Personal consumption makes up almost 70 percent of gross domestic product, so consumer engagement is extremely important for economic activity. A severe recession may turn into a **depression**, in which unemployment is very high, consumer spending is low, and business output is sharply reduced, such as what occurred in the United States in the early 1930s.

Economies expand and contract in response to changes in consumer, business, and government spending. War also can affect an economy, sometimes stimulating it (as in the United States during World Wars I and II) and sometimes stifling it (as during the Vietnam, Persian Gulf, and Iraq wars). Although fluctuations in the economy are inevitable and to a certain extent predictable, their effects—inflation and unemployment—disrupt lives, and thus governments try to minimize them.

Measuring the Economy Countries measure the state of their economies to determine whether they are expanding or contracting and whether corrective action is necessary to minimize the fluctuations. One commonly used measure is **gross domestic product (GDP)**—the sum of all goods and services produced in a country during a year. GDP measures only those goods and services made within a country and therefore does not include profits from companies' overseas operations; it does include profits earned by foreign companies within the country being measured. However, it does not take into account the concept of GDP in relation to population (GDP per capita). Figure 1.4 shows the increase in U.S. GDP over several years.

Another important indicator of a nation's economic health is the relationship between its spending and income (from taxes). When a nation spends more than it

depression

a condition of the economy in which unemployment is very high, consumer spending is low, and business output is sharply reduced.

LO 1-6

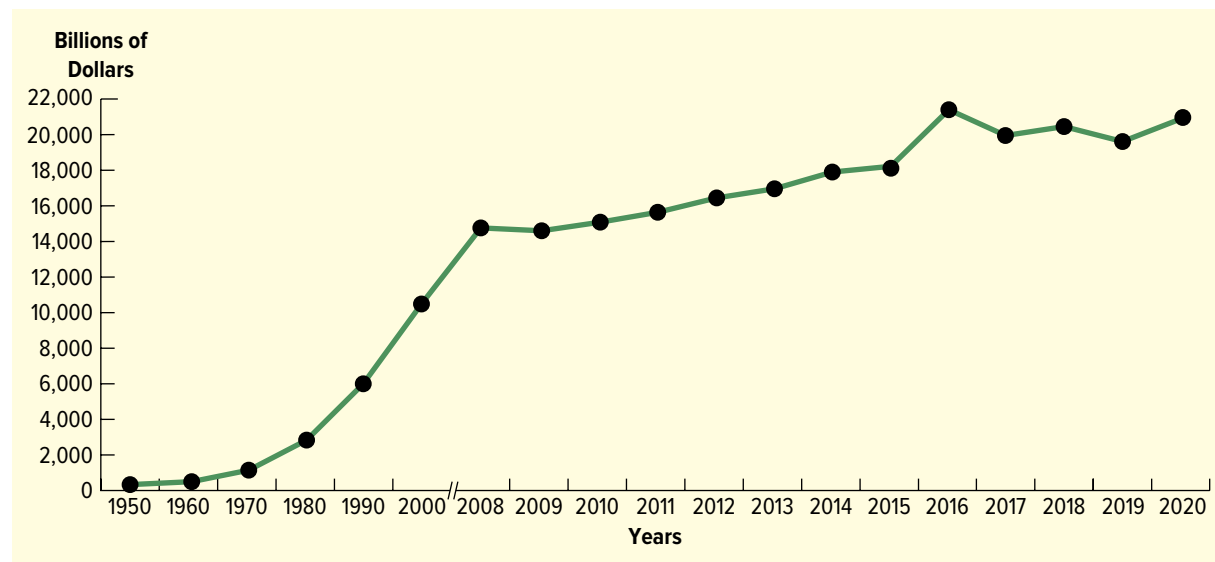
Specify why and how the health of the economy is measured.

gross domestic product (GDP)

the sum of all goods and services produced in a country during a year.

FIGURE 1.4

Change in U.S. Gross Domestic Product



Source: U.S. Department of Commerce Bureau of Economic Analysis, "National Economic Accounts," www.bea.gov/national/index.htm#gdp (accessed July 20, 2021).

TABLE 1.2
How Do We Evaluate Our
Nation's Economy?

Unit of Measure	Description
Trade balance	The difference between our exports and our imports. If the balance is negative, as it has been since the mid-1980s, it is called a trade deficit and is generally viewed as unhealthy for our economy.
Consumer Price Index	Measures changes in prices of goods and services purchased for consumption by typical urban households.
Per capita income	Indicates the income level of "average" Americans. Useful in determining how much "average" consumers spend and how much money Americans are earning.
Unemployment rate	Indicates how many working-age Americans are not working who otherwise want to work.
Inflation	Monitors price increases in consumer goods and services over specified periods of time. Used to determine if costs of goods and services are exceeding worker compensation over time.
Worker productivity	The amount of goods and services produced for each hour worked.

budget deficit
the condition in which a nation spends more than it takes in from taxes.

takes in from taxes, it has a **budget deficit**. In the 1990s, the U.S. government eliminated its long-standing budget deficit by balancing the money spent for social, defense, and other programs with the amount of money taken in from taxes.

In recent years, however, the budget deficit has reemerged and grown to record levels. Because many Americans do not want their taxes increased and Congress has difficulty agreeing on appropriate tax rates, it is difficult to increase taxes and reduce the deficit. Like consumers and businesses, when the government needs money, it borrows from the public, banks, and even foreign investors. The national debt is more than \$27 trillion.¹⁵ This figure is especially worrisome because to reduce the debt to a manageable level, the government either has to increase its revenues (raise taxes) or reduce spending on social, defense, and legal programs, neither of which is politically popular. The national debt figure changes daily and can be seen at the Department of the Treasury, Bureau of the Public Debt, website. Table 1.2 describes some of the other ways we evaluate our nation's economy.

LO 1-7

Outline the evolution of the American economy.

standard of living
refers to the level of wealth and material comfort that people have available to them.

The American Economy

As we said previously, the United States is a mixed economy with a foundation based on capitalism. The answers to the three basic economic issues are determined primarily by competition and the forces of supply and demand, although the federal government does intervene in economic decisions to a certain extent. For instance, the federal government exerts oversight over the airline industry to make sure airlines remain economically viable as well as for safety and security purposes.

Standard of living refers to the level of wealth and material comfort that people have available to them. The United States, Germany, Australia, and Norway all have a high standard of living, meaning that most of their citizens are able to afford basic necessities and some degree of comfort. These nations are often characterized by a high GDP per capita. However, a higher GDP per capita does not automatically translate into a higher standard of living. Costs of goods and services are also factors. The European Union and Japan, for instance, tend to have higher costs of living than in the

United States. Higher prices mean that it costs more to obtain a certain level of comfort than it does in other countries. Countries with low standards of living are usually characterized by poverty, higher unemployment, and lower education rates. To understand the current state of the American economy and its effect on business practices, it is helpful to examine its history and the roles of the entrepreneur and the government.

The Importance of the American Economy

The American economy is an **open economy**, or an economy in which economic activities occur between the country and the international community. As an open economy, the United States is a major player in international trade. Open economies tend to grow faster than economies that do not engage in international trade. This is because international trade is positively related to efficiency and productivity. Companies in the United States have greater access to a wider range of resources and knowledge, including technology. In today's global environment, the ability to harness technology is critical toward increased innovation.¹⁶ In contrast, research indicates a negative relationship between regulatory actions and innovation in firms, suggesting that too much regulation hinders business activities and their contribution to the American economy.¹⁷

open economy
an economy in which economic activities occur between the country and the international community.

When looking at the American economy, growth in GDP and jobs are the two primary factors economists consider. A positive relationship exists between a country's employment rate and economic growth. A nation's output depends on the amount of labor used in the production process, so there is also a positive correlation between output and employment. In general, as the labor force and productivity increase, so does GDP. Profitable companies tend to hire more workers than those that are unprofitable. Therefore, companies that hire employees not only improve their profitability but also drive the economic well-being of the American economy.¹⁸

Government public policy often moves quickly to protect the economy. For example, during the COVID-19 pandemic, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act to provide financial assistance to individuals, small businesses, state and local governments, as well as some larger firms. This historic action was designed to protect the economy while many businesses had to close to prevent the spread of the virus.¹⁹

Government public policy also drives the economy through job creation. In order for any nation to ensure the social and economic health of the country, there must be a tax base to provide for the public interest. The vast majority of taxes come from individuals. It is estimated that individual income taxes contribute nearly \$2 trillion to the U.S. government's total revenue, while corporate taxes contribute \$284 billion.²⁰ Individuals who earn more than \$510,300 pay 37 percent of individual income taxes.²¹

Business is also an important source of tax revenue. Those that are classified as sole proprietorships, partnerships, and S corporations (discussed further in the chapter titled "Options for Organizing Business") pay taxes according to the individual income tax code. Corporations are taxed differently. Approximately 4.4 percent of the government's total revenues come from corporate income taxes.²² In 2017, the largest tax reform in the U.S. tax rate in over 30 years changed the corporate tax rate from 35 percent to 21 percent.²³ The average global corporate tax rate is 24 percent, while some countries such as Ireland have a corporate tax rate as low as 12.5 percent. The U.S. tax reform lowered the highest individual tax rate from 39.6 percent to 37 percent, but the reform capped the deduction of state and local taxes at \$10,000.²⁴ The Biden administration proposes to increase both corporate income taxes and individual income taxes for those in higher income brackets.

A Brief History of the American Economy

The Early Economy Before the colonization of North America, Native Americans lived as hunter/gatherers and farmers, with some trade among tribes. The colonists who came later operated primarily as an *agricultural economy*. People were self-sufficient and produced everything they needed at home, including food, clothing, and furniture. Abundant natural resources and a moderate climate nourished industries such as farming, fishing, shipping, and fur trading. A few manufactured goods and money for the colonies' burgeoning industries came from England and other countries.

As the nation expanded slowly toward the West, people found natural resources such as coal, copper, and iron ore and used them to produce goods such as horse-shoes, farm implements, and kitchen utensils. Farm families who produced surplus goods sold or traded them for things they could not produce themselves, such as coffee, salt, and farm equipment. Some families also spent time turning raw materials into clothes and household goods. Because these goods were produced at home, this system was called the domestic system.

DID YOU KNOW? Approximately 70 percent of women with children under the age of 18 are involved in the workforce.^d

The Industrial Revolution The 19th century and the Industrial Revolution brought the development of new technology and factories. The factory brought together all the resources needed to make a product—materials, machines, and workers. Work in factories became specialized as workers focused on one or two tasks. As work became more efficient, productivity increased, making more goods available at lower prices. Railroads brought major changes, allowing farmers to send their agricultural products all over the nation to markets.

Factories began to spring up along the railways to manufacture farm equipment and products such as textiles, clothing, and household items to be shipped by rail. Eli Whitney revolutionized the cotton industry with his cotton gin. John Deere's farm equipment increased farm production and reduced the number of farmers required to feed the young nation. Farmers began to move to cities to find jobs in factories and a higher standard of living. Henry Ford developed the assembly-line system to produce automobiles. Workers focused on one part of an automobile and then pushed it to the next stage until it rolled off the assembly line as a finished automobile. Ford's assembly line could manufacture many automobiles efficiently, and the price of his cars was \$200, making them affordable to many Americans.

The Manufacturing and Marketing Economies Industrialization brought increased prosperity, and the United States gradually became a *manufacturing economy*—one devoted to manufacturing goods and providing services rather than producing agricultural products. Businesses became more concerned with the needs of the consumer and entered the *marketing economy*. Marketing advanced when Alexander Turney Stewart built one of the first department stores in the 1860s. Aaron Montgomery Ward developed a catalog in 1872 with 10,000 items that could be shipped by train. The development of retail institutions created the demand for more manufactured products. Companies conducted research to find out what products consumers needed and wanted. Advertising made consumers aware of products and important information about features, prices, and other competitive advantages.

Because these developments occurred in a free-enterprise system, consumers determined what goods and services were produced. They did this by purchasing the products they liked at prices they were willing to pay. The United States prospered, and American citizens had one of the highest standards of living in the world.

The Service and New Digital Economy After World War II, with the increased standard of living, Americans had more money and more time. They began to pay others to perform services that made their lives easier. Beginning in the 1960s, more and more women entered the workforce. The United States began experiencing major shifts in the population. The U.S. population experienced the slowest pace of growth since the Great Depression, with the South leading the population gains. While the birth rate in the United States is declining, new immigrants help with population gains.²⁵ The profile of the family is also changing: Today there are more single-parent families and individuals living alone, and in two-parent families, both parents often work.

One result of this trend is that time-pressed Americans are increasingly paying others to do tasks they used to do at home, like cooking, laundry, landscaping, and child care. These trends have gradually changed the United States to a *service economy*—one devoted to the production of services that make life easier for busy consumers. Businesses increased their demand for services, especially in the areas of finance and information technology. Service industries such as restaurants, banking, health care, child care, auto repair, leisure-related industries, and even education are growing rapidly and may account for as much as 80 percent of the U.S. economy. These trends continue with advanced technology contributing to new service products based on technology and digital media that provide smartphones, social networking, and virtual worlds. This has led to the growth of e-commerce, or transactions involving goods and services over the internet. E-commerce has led to firms that would have been unheard of a few decades ago, such as eBay, Shopify, Etsy, and Amazon. More about the digital world, business, and new online social media can be found in the chapter titled “Digital Marketing and Social Media.”

The economy experienced a major shift in 2020 as a result of the COVID-19 pandemic. Travel bans were issued, people across the globe were ordered to stay at home, nonessential businesses were closed, students attended school online, major events were canceled, and many people began to work remotely. Even as businesses began to reopen, the world experienced a new normal. As working from home became mainstream, many companies reevaluated their real estate needs and permanently shuttered offices in major cities, impacting the commercial real-estate market.²⁶ Online grocery ordering gained popularity, telemedicine became widespread, and shopping shifted online. In fact, roughly 100,000 stores are estimated to close before 2025, according to UBS, an investment banking company.²⁷ Additionally, the virus accelerated the adoption of certain technologies in business such as cloud technology, cybersecurity, and artificial intelligence.²⁸

Technology and the Economy

Technology is rapidly accelerating and is changing the environment of business. **Technology** includes the methods and processes creating applications to solve problems, perform tasks, and make decisions. New technology associated with artificial intelligence enabled by big data and advanced computing systems is changing the way work is accomplished. The result is disruptive technology such as smart buildings, digital wallets, and drones, robotics, and machines that can communicate and make decisions like humans. This creates opportunities for new business models and job opportunities.

Artificial intelligence (AI) relates to machine (computer) learning that is able to perform activities and tasks that usually require human intelligence such as decisions, visual perception, and speech recognition. In short, it makes computers act like humans.

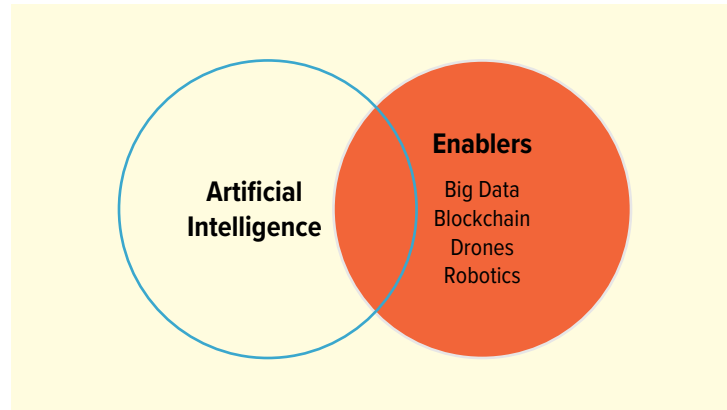
technology

includes the methods and processes creating applications to solve problems, perform tasks, and make decisions.

artificial intelligence (AI)

relates to machine (computer) learning that is able to perform activities and tasks that usually require human intelligence.

FIGURE 1.5
AI in Relation to Its
Enablers



Although it's estimated AI will disrupt 25 percent of U.S. jobs, the timeline is uncertain. However, the World Economic Forum predicts that AI will create more jobs than it takes, including new roles that do not exist today. Because of this, educational institutions and business will need to keep employment dynamic by providing individuals with the soft skills needed to work alongside AI and its enablers.²⁹ AI's enablers, as seen in Figure 1.5, include big data, blockchain, drones, robotics, and more.

AI is moving rapidly across business functions because it can resolve predictable business activities. For example, using machine technology to analyze thousands of emails with customer service concerns can create a response that is faster and more accurate than using humans to respond. Delta uses an AI-powered business chat tool to supplement its customer service team, allowing its agents to handle more complex tasks while responding to a higher volume of inquiries.³⁰ Approximately 40 percent of Americans who use the internet indicate they would rather use digital customer services than speak to a service provider on the phone.³¹ Additionally, AI has the potential to make the world more efficient in predictable, physical work such as assembly lines, food preparation, packaging, welding, and other repetitive tasks.

While it has the potential to provide greater productivity and higher quality service, it also creates new challenges.³² For instance, AI has the potential to be just as biased as humans because it can adopt preexisting human biases and engage in unintentional discrimination.³³ Surveillance is another sensitive issue that is related to privacy. Facial recognition has been found to falsely identify Asian and African American faces 10 to 100 times more often than Caucasian faces, according to the National Institute of Standards and Technology.³⁴ Tracking communication, profiles, and other searchable information will accelerate with AI.

Business have an unprecedented amount of data at their fingertips. **Big data** refers to large volumes of structured and unstructured data that are transmitted at very fast speeds. AI systems learn from big data, such as consumer shopping habits, web browsing history, and social media activity. Insights from big data can improve decision making and inform business strategies. For example, Johnson & Johnson uses big data to determine the likelihood of success for new drugs.³⁵ However, the amount of data available to businesses creates consumer privacy concerns. Half of business ethics violations are related to the improper use of big data analytics, according to Gartner.³⁶ It's important for businesses to consider the best ways to collect, store, and share consumer data.

Blockchain will enable AI with the development of databases that can be used in AI learning. **Blockchain** is a decentralized record-keeping technology that stores linked

big data

refers to large volumes of structured and unstructured data that are transmitted at very fast speeds.

blockchain

a decentralized record-keeping technology that stores linked blocks of ordered transactions over time.

blocks of ordered transactions over time. The distinguishing feature of a blockchain is the ordered rules of how the data go into the database. The data are locked into a system without a central person controlling them. The key is no single authority can make changes to fit their needs. The finance industry, supply chain, marketing, human resource management, and most other areas of business will become more efficient in developing and tracking information.³⁷

Blockchain has the potential to make databases and digital infrastructures more secure and trustworthy; for example, scanning data in a blockchain database and tracking products from a point of production to consumption. For this reason, blockchain is especially important in managing the supply chain. It can track product history, generate invoices, detect counterfeit products, manage returned products, and help find and reuse materials rather than new resources. It can enable firms to trace deliveries, verify transactions, and handle payments. It is transforming the supply side of business.³⁸ This means that the movement of agricultural products, for instance, can be tracked from the farm to the table. Walmart uses the technology to track its products through the entire supply chain to the store. According to Walmart, the time it takes to trace the origin of an item decreased from seven days to 2.2 seconds.³⁹

Drones, unmanned aerial devices, can be programmed with AI to perform human tasks such as delivering products or collecting environmental data and imagery. Drones can be beneficial in a variety of industries such as construction, farming, defense, insurance, outdoor entertainment, and retail. UPS uses drones to deliver prescription medication from CVS to retirees in Florida.⁴⁰ As of now, adoption of this technology is limited because few companies have permission from the Federal Aviation Administration (FAA) to fly drones beyond visual line of sight.⁴¹ Drones pose a challenge not only to airspace but privacy as well. Though businesses may not intentionally surveil the population, drones with cameras have the potential to take photos and videos of people without their consent.

In addition to drones, robots can be programmed with AI to perform human-like actions by learning, reasoning, and using language through machine learning. Lowe's, for instance, has a customer service robot called OSHbot that can speak with customers in multiple languages and help locate items in the store. Robots used in this type of application can efficiently and effectively assist customers. As with AI's other enablers, privacy is a concern with robots because they have the potential to collect sensitive data that could violate an individual's privacy.⁴²

AI and its enablers are rapidly changing the world of business. Big data can be combined with AI machine learning to provide important information and help leaders make decisions on key issues. Blockchain combined with AI can enable new business models. For example, cryptocurrency such as bitcoin is based on blockchain technology. Drones can help extend the reach of businesses, and robots can create a personalized shopping experience. These advanced technologies will make it possible to create entrepreneurs that will develop new business.

The Role of the Entrepreneur

An **entrepreneur** is an individual who risks money, time, and effort to develop for profit an innovative product or way of doing something. Heidi Ganahl is a true American entrepreneur. She took the unusual concept of a day care center for dogs and turned it into a successful \$85 million franchise operation with Camp Bow Wow, which offers boarding, playtime, grooming, and other services for dogs. Additionally, Ganahl founded a startup incubator called Fight Back Foundation to support social entrepreneurs.⁴³

drones
unmanned aerial devices.

entrepreneur
an individual who risks money, time, and effort to develop for profit an innovative product or way of doing something.

LO 1-8

Explain the role of the entrepreneur in the economy.



Ripe.io aims to use blockchain technology to address issues like food fraud and food safety in the restaurant industry. The agritech startup has worked with restaurants like Sweetgreen to track produce from farm to restaurant.



Apple Pay is a mobile payment system that allows users to store credit card or debit card information on their phones. When checking out at stores, users can bring up their credit card with two taps and use the information to pay for their purchases.

The free-enterprise system provides the conditions necessary for entrepreneurs like Ganahl to succeed. In the past, entrepreneurs were often inventors who brought all the factors of production together to produce a new product. Thomas Edison, whose inventions include the record player and light bulb, was an early American entrepreneur. Henry Ford was one of the first persons to develop mass assembly methods in the automobile industry. Other entrepreneurs, so-called captains of industry, invested in the country's growth. John D. Rockefeller built Standard Oil out of the fledgling oil industry, and Andrew Carnegie invested in railroads and founded the United States Steel Corporation. Andrew Mellon built the Aluminum Company of America and Gulf Oil. J. P. Morgan started financial institutions to fund the business activities of other entrepreneurs. Although these entrepreneurs were born in another century, their legacy to the American economy lives on in the companies they started, many of which still operate today. Consider the history of Eli Lilly. Colonel Eli Lilly in Indianapolis, Indiana, was continually frustrated with the quality of pharmaceutical products sold at the time. As a pharmaceutical chemist, he decided to start his own firm that would offer the highest-quality medicines. His firm, Eli Lilly and Company, would go on to make landmark achievements, including being one of the first pharmaceutical firms to mass-produce penicillin. Today, Eli Lilly is one of the largest pharmaceutical firms in the world.⁴⁴

Entrepreneurs are constantly changing American business practices with new technology and innovative management techniques. Bill Gates, for example, built Microsoft, a software company whose products include Word and Windows, into a multibillion-dollar

enterprise. Frederick Smith had an idea to deliver packages overnight, and now his FedEx Company plays an important role in getting documents and packages delivered all over the world for businesses and individuals. Steve Jobs co-founded Apple and turned the company into a successful consumer electronics firm that revolutionized many different industries, with products such as the iPod. Entrepreneurs have been associated with such uniquely American concepts as Walt Disney, Spanx, Tesla,



Technology and the Economy

Up in the Air: Drones and Air Traffic Control

The U.S. practices modified capitalism, where free enterprise is encouraged, but the government intervenes and regulates business to some extent. Air traffic control, for instance, is run by the government to regulate and manage air space. While this type of government control works for airplanes, the rise of a new type of product taking to the skies calls for a more autonomous type of control.

As drones increase in popularity, the need for a new air traffic control system has increased. As many as 7 million drones could be in the sky at once, according to the Federal Aviation Administration (FAA). Drones are used to take pictures, deliver packages, inspect infrastructure, and more.

Companies like Amazon, Airbus, and Google are leading the charge for a private, nationwide drone air traffic control system. Unlike the air traffic control system for airplanes, this drone system is private. Eight companies, including T-Mobile and Intel, have been selected to develop the technology that

will enable remote drone identification. The FAA will define a drone traffic management framework that commercial operators will follow.

Drones would use sensors to scan their surroundings and broadcast that information to other drones around them. This proposed system could lead to an overhaul of the air traffic control system, which has remained largely unchanged since the 1940s, because the same infrastructure could be applied to airplanes. Technology is evolving fast, and a future where the skies are filled with drones is not far away.^e

Critical Thinking Questions

1. How does this situation demonstrate a modified capitalist economic system?
2. What is the difference between the current air traffic control system and the proposed air traffic control system for drones?
3. Why would it be harder for the government to maintain as much control over drones as it does for airplanes?

McDonald's, SpaceX, Google, Facebook, and Walmart. We will examine the importance of entrepreneurship further in the chapter "Small Business, Entrepreneurship, and Franchising."

The Role of Government in the American Economy

The American economic system is best described as modified capitalism because the government regulates business to preserve competition and protect consumers and employees. Federal, state, and local governments intervene in the economy with laws and regulations designed to promote competition and to protect consumers, employees, and the environment. Many of these laws are discussed in Bonus Chapter A.

Additionally, government agencies such as the U.S. Department of Commerce measure the health of the economy (GDP, productivity, etc.) and, when necessary, take steps to minimize the disruptive effects of economic fluctuations and reduce unemployment. When the economy is contracting and unemployment is rising, the federal government through the Federal Reserve Board (see chapter titled "Money and the Financial System") tries to spur growth so that consumers will spend more money and businesses will hire more employees. To accomplish this, it may reduce interest rates or increase its own spending for goods and services. When the economy expands so fast that inflation results, the government may intervene to reduce inflation by slowing down economic growth. This can be accomplished by raising interest rates

to discourage spending by businesses and consumers. Techniques used to control the economy are discussed in “Money and the Financial System.”

The Role of Ethics and Social Responsibility in Business

While most businesses are ethical and socially responsible, there are incidences of misconduct. In many cases, misconduct by individuals within firms has an adverse effect on employees, investors, and other stakeholders. This misconduct undermines public confidence in corporate America and creates debates about ethics in business. *Business ethics* generally refers to the standards and principles used by society to define appropriate and inappropriate conduct in the workplace. In many cases, these standards have been codified as laws prohibiting actions deemed unacceptable.

Society is increasingly demanding that businesspeople behave socially responsibly toward their stakeholders, including customers, employees, investors, government regulators, communities, and the natural environment. Diversity in the workforce is not only socially responsible, but also highly beneficial to the financial performance of companies. According to a McKinsey consulting firm study, organizations that have diverse leadership are more likely to report higher financial returns. Diversity creates increased employee satisfaction and improved decision making.⁴⁵ When actions are heavily criticized, a balance is usually required to support and protect various stakeholders.

While one view is that ethics and social responsibility are a good supplement to business activities, there is an alternative viewpoint. Ethical behavior can not only enhance a company's reputation, but can also drive profits.⁴⁶ The ethical and socially responsible conduct of companies such as Microsoft, Patagonia, and Ben & Jerry's provides evidence that good ethics is good business. There is growing recognition that the long-term value of conducting business in an ethical and socially responsible manner that considers the interests of all stakeholders creates superior financial performance.⁴⁷

To promote socially responsible and ethical behavior while achieving organizational goals, businesses can monitor changes and trends in society's values. Businesses should determine what society wants and attempt to predict the long-term effects of their decisions. While it requires an effort to address the interests of all stakeholders, businesses can prioritize and attempt to balance conflicting demands. The goal is to develop a solid reputation of trust and avoid misconduct to develop effective workplace ethics. Fortunately, most businesses embrace this goal.

Can You Learn Business in a Classroom?

Obviously, the answer is yes, or there would be no purpose for this textbook or course! To be successful in business, you need knowledge, skills, experience, and good judgment. The topics covered in this chapter and throughout this book provide some of the knowledge you need to understand the world of business. In addition, the “Build Your Skills” exercise will help you develop skills that may be useful in your future career. However, good judgment is based on knowledge and experience plus personal insight and understanding. Therefore, you need more courses in business, along with some practical experience in the business world, to help you develop the special insight necessary to put your personal stamp on knowledge as you apply it. The challenge in business is in the area of judgment, and judgment does not develop from memorizing an introductory business textbook. If you are observant in your daily experiences as an

employee, as a student, and as a consumer, you will improve your ability to make good business judgments.

Whether you choose to work at an organization or become an entrepreneur, you will be required to know the basic concepts and principles in this book. You need to be prepared for changes in the way business will be conducted in the future. New business models or ways businesses create value will emerge based on the internet, connected technologies, drones, driverless cars, and artificial intelligence. It should be exciting to think about your opportunities and the challenges of creating a successful career. Our society needs a strong economic foundation to help people develop a desired standard of living. Our world economy is becoming more digital and competitive, requiring new skills and job positions. Individuals like you can become leaders in business, nonprofits, and government to create a better life.

Figure 1.6 is an overview of how the chapters in this book are linked together and how the chapters relate to the participants, the activities, and the environmental factors found in the business world. The topics presented in the chapters that follow are those that will give you the best opportunity to begin the process of understanding the world of business.

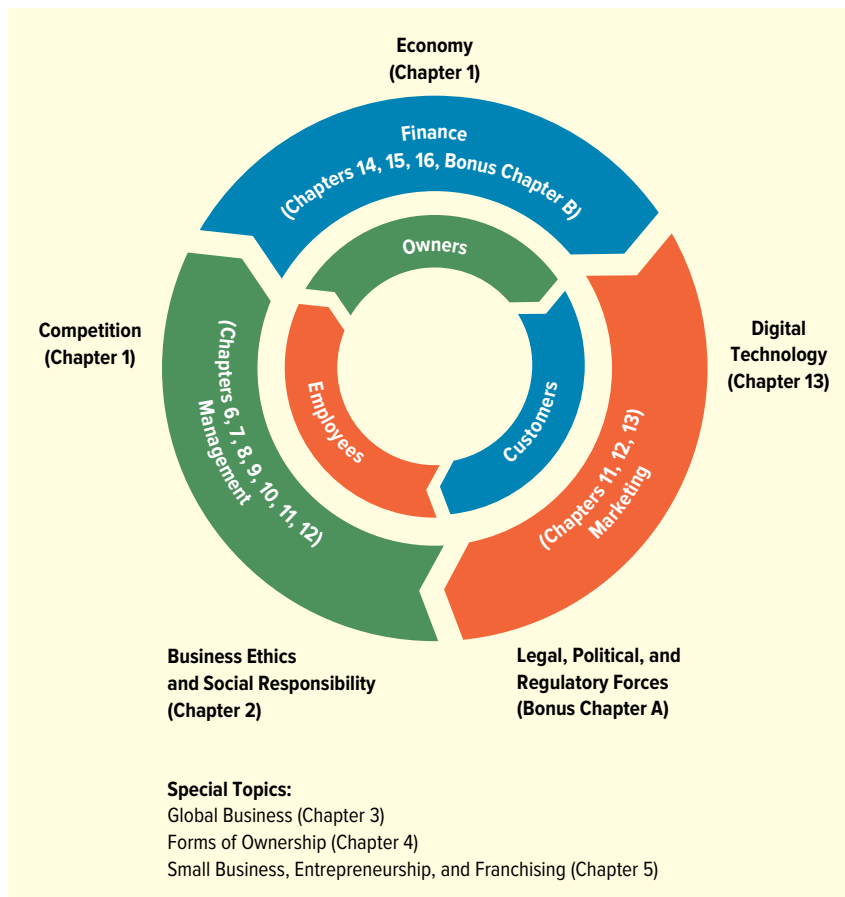


FIGURE 1.6
The Organization of This Book

So You Want a Job in the Business World



When most people think of a career in business, they see themselves entering the door to large companies and multinationals that they read about in the news and that are discussed in class. In a national survey, students indicated they would like to work for Google, Disney, Apple, and Ernst & Young. In fact, most jobs are not with large corporations, but are in small companies, nonprofit organizations, government, and even as self-employed individuals. There are nearly 27 million individuals in the United States who own their own businesses and have no employees. With more than 75 percent of the economy based on services, there are many jobs available in industries such as health care, finance, education, hospitality, and entertainment. E-commerce is creating the need for supply chain jobs related to purchasing, transportation, and operations. The world is changing quickly, and large corporations replace the equivalent of their entire workforce every four years.

The fast pace of technology today means that you have to be prepared to take advantage of emerging job opportunities and markets. You must also become adaptive and recognize that business is becoming more global, with job opportunities around the world. If you want to obtain such a job, you

shouldn't miss a chance to spend some time overseas. To get you started on the path to thinking about job opportunities, consider all of the changes in business today that might affect your possible long-term track and that could bring you lots of success. Companies are looking for employees with skills that can be used to address the changing business environment. For example, the demand for graduates that are good at analyzing data and navigating cloud-based computing is on the rise.

You're on the road to learning the key knowledge, skills, and trends that you can use to be a star in business. Business's impact on our society, especially in the area of sustainability and improvement of the environment, is a growing challenge and opportunity. Green businesses and green jobs in the business world are provided to give you a glimpse at the possibilities. Along the way, we will introduce you to some specific careers and offer advice on developing your own job opportunities. Research indicates that you won't be that happy with your job unless you enjoy your work and feel that it has a purpose. Because you spend most of your waking hours every day at work, you need to seriously think about what is important to you in a job.⁴⁸

Review Your Understanding

Define basic concepts such as business, product, profit, and economics.

A business is an organization or individual that seeks a profit by providing products that satisfy people's needs. A product is a good, service, or idea that has both tangible and intangible characteristics that provide satisfaction and benefits. Profit, the basic goal of business, is the difference between what it costs to make and sell a product and what a customer pays for it. Economics is the study of how resources are distributed for the production of goods and services within a social system.

Identify the main participants and activities of business.

The three main participants in business are owners, employees, and customers, but others—government regulators, suppliers, social groups, etc.—are also important. Management involves planning, organizing, and controlling the tasks required to carry out the work of the company. Marketing refers to those activities—research, product development, promotion, pricing, and distribution—designed to provide goods and services that satisfy customers. Finance refers to activities concerned with funding a business and using its funds effectively.

Explain why studying business is important.

Studying business can help you prepare for a career and become a better consumer.

Compare the four types of economic systems.

An economic system describes how a particular society distributes its resources. Communism is an economic system in which the people, without regard to class, own all the nation's resources. In a socialist system, the government owns and operates basic industries, but individuals own most businesses. Under capitalism, individuals own and operate the majority of businesses that provide goods and services. Mixed economies have elements from more than one economic system; most countries have mixed economies.

Describe the role of supply, demand, and competition in a free-enterprise system.

In a free-enterprise system, individuals own and operate the majority of businesses, and the distribution of resources is determined by competition, supply, and demand. Demand is the number of goods and services that consumers are willing to buy at different prices at a specific time. Supply is the number of goods or services that businesses are willing to

sell at different prices at a specific time. The price at which the supply of a product equals demand at a specific point in time is the equilibrium price. Competition is the rivalry among businesses to convince consumers to buy goods or services. Four types of competitive environments are pure competition, monopolistic competition, oligopoly, and monopoly. These economic concepts determine how businesses may operate in a particular society and, often, how much they can charge for their products.

Specify why and how the health of the economy is measured.

A country measures the state of its economy to determine whether it is expanding or contracting and whether the country needs to take steps to minimize fluctuations. One commonly used measure is gross domestic product (GDP), the sum of all goods and services produced in a country during a year. A budget deficit occurs when a nation spends more than it takes in from taxes.

Outline the evolution of the American economy.

The American economy is an open economy that engages in significant international trade. Government public policy

helps drive the economy through job creation, requiring a tax base to provide for the public interest. Much of the government's revenue comes from individual income taxes, but corporations pay a high corporate tax in the United States.

The American economy has evolved through several stages: the early economy, the Industrial Revolution, the manufacturing economy, the marketing economy, and the service and internet-based economy of today.

Explain the role of the entrepreneur in the economy.

Entrepreneurs play an important role because they risk their time, wealth, and efforts to develop new goods, services, and ideas that fuel the growth of the American economy.

Evaluate a small-business owner's situation and propose a course of action.

"Solve the Dilemma" near the end of this chapter presents a problem for the owner of the firm. Should you, as the owner, raise prices, expand operations, or form a venture with a larger company to deal with demand? You should be able to apply your newfound understanding of the relationship between supply and demand to assess the situation and reach a decision about how to proceed.

Learn the Terms

artificial intelligence (AI) 21	economics 8	open economy 19
big data 22	entrepreneur 23	product 4
blockchain 22	equilibrium price 13	profit 4
budget deficit 18	financial resources (capital) 8	pure competition 14
business 4	free-market system 10	recession 15
capitalism (free enterprise) 10	gross domestic product (GDP) 17	socialism 9
communism 9	human resources (labor) 8	stakeholders 5
competition 14	inflation 15	standard of living 18
demand 12	mixed economies 11	supply 12
depression 17	monopolistic competition 14	technology 21
drones 23	monopoly 15	unemployment 15
economic contraction 15	natural resources 8	
economic expansion 15	nonprofit organizations 4	
economic system 8	oligopoly 15	

Check Your Progress

1. What is the fundamental goal of business? Do all organizations share this goal?
2. Name the forms a product may take and give some examples of each.
3. Who are the main participants of business? What are the main activities? What other factors have an impact on the conduct of business in the United States?
4. What are four types of economic systems? Can you provide an example of a country using each type?

5. Explain the terms *supply*, *demand*, *equilibrium price*, and *competition*. How do these forces interact in the American economy?
6. List the four types of competitive environments and provide an example of a product of each environment.
7. List and define the various measures governments may use to gauge the state of their economies. If unemployment is high, will the growth of GDP be great or small?
8. How did the Industrial Revolution influence the growth of the American economy? Why do we apply the term *service economy* to the United States today?
9. How has technology changed the business environment?
10. Explain the federal government's role in the American economy.

Get Involved

1. Who are today's most innovative entrepreneurs? How have they contributed to society and the world of business?
2. Why is it important for the government to measure the economy? What kinds of actions might it take to control the economy's growth?
3. Is the American economy currently expanding or contracting? Defend your answer with the latest statistics on GDP, inflation, unemployment, and so on. How is the federal government responding?

Build Your Skills

The Forces of Supply and Demand

Background



WagWumps are a new children's toy with the potential to be a highly successful product. WagWumps are cute and furry, and their eyes glow in the dark. Each family set consists of a mother, a father, and two children. Wee-Toys'

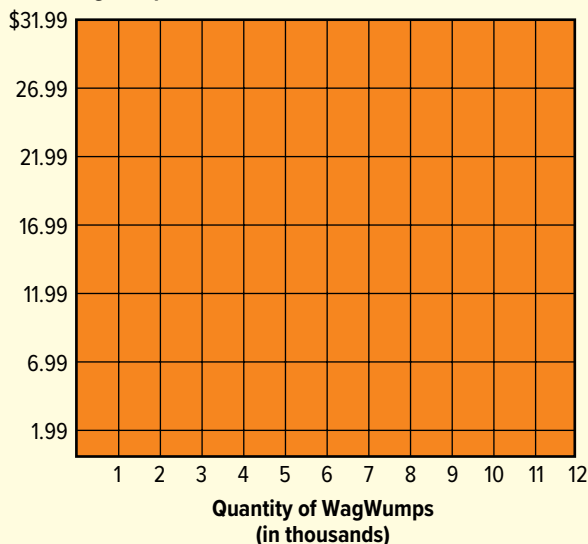
manufacturing costs are about \$6 per set, with \$3 representing marketing and distribution costs. The wholesale price of a WagWump family for a retailer is \$15.75, and the toy carries a suggested retail price of \$26.99.

Task

Assume you are a decision maker at a retailer, such as Target or Walmart, that must determine the price the stores in your district should charge customers for the WagWump

FIGURE 1.7
Equilibrium Price of
WagWumps

Prices of WagWumps



family set. From the information provided, you know that the SRP (suggested retail price) is \$26.99 per set and that your company can purchase the toy set from your wholesaler for \$15.75 each. Based on the following assumptions, plot your company's supply curve on the graph provided in Figure 1.7 and label it "supply curve."

Quantity	Price
3,000	\$16.99
5,000	21.99
7,000	26.99

Using the following assumptions, plot your customers' demand curve on Figure 1.7 and label it "demand curve."

Quantity	Price
10,000	\$16.99
6,000	21.99
2,000	26.99

For this specific time, determine the point at which the quantity of toys your company is willing to supply equals the quantity of toys the customers in your sales district are willing to buy and label that point "equilibrium price."

Solve the Dilemma

Mrs. Acres Homemade Pies



Shelly Acres, whose grandmother gave her a family recipe for making pies, loved to cook, and she decided to start a business she called Mrs. Acres Homemade Pies. The company produces specialty pies and sells them in local supermarkets and select family restaurants. In each of the first six months, Shelly and three part-time employees sold 2,000 pies for \$4.50 each, netting \$1.50 profit per pie. The pies were quite successful and Shelly could not keep up with demand. The company's success results from a quality product and productive employees who are motivated by incentives and who enjoy being part of a successful new business.

To meet demand, Shelly expanded operations, borrowing money and increasing staff to four full-time employees. Production and sales increased to 8,000 pies per month, and profits soared to \$12,000 per month. However, demand

for Mrs. Acres Homemade Pies continues to accelerate beyond what Shelly can supply. She has several options: (1) maintain current production levels and raise prices; (2) expand the facility and staff while maintaining the current price; or (3) contract the production of the pies to a national restaurant chain, giving Shelly a percentage of profits with minimal involvement.

LO 1-9

Evaluate a small-business owner's situation and propose a course of action.

Critical Thinking Questions

1. Explain and demonstrate the relationship between supply and demand for Mrs. Acres Homemade Pies.
2. What challenges does Shelly face as she considers the three options?
3. What would you do in Shelly's position?

Build Your Business Plan

The Dynamics of Business and Economics



Have you ever thought about owning your business? If you have, how did your idea come about? Is it your experience with this particular field? Or might it be an idea that evolved from your desires for a particular good or service not being offered in your community? For example, perhaps you and your friends have yearned for a place to go have coffee, relax, and talk. Now is an opportunity to create the cafe bar you have been thinking of!

Whether you consider yourself a visionary or a practical thinker, think about your community. What needs are not

being met? While it is tempting to suggest a new restaurant (maybe even one near campus), easier-to-implement business plans can range from a lawn care business or a designated driver business to a placement service agency for teenagers.

Once you have an idea for a business plan, think about how profitable this idea might be. Is there sufficient demand for this business? How large is the market for this particular business? What about competitors? How many are there?

To learn about your industry, you should do a thorough search of your initial product ideas on the internet.

See for Yourself Case

Tesla: More Than a Car Company



Tesla, an all-electric vehicle and energy generation products company, is widely admired for its industry-altering innovation built around its core vision of moving the world toward sustainable energy. Though Tesla got its start with electric vehicles (EVs) in 2003, the company has branched out to create a variety of renewable energy technologies from solar roof tiles to clean energy storage. Today, Tesla is one of the most valuable car makers in the United States.

Tesla did not invent the EV, but it was the first to create a viable EV for consumers and has set the standard of what an electric car should be. In 2003 Martin Eberhard and Marc Tarpenning set out to create a high-end performance EV, targeting wealthy car enthusiasts. Elon Musk joined the company in 2004 after investing \$30 million and becoming the chair of the board of directors. After years of testing and designing components and prototypes, the company finally introduced the Roadster in 2008, the same year Musk became Tesla's CEO.

Before the Roadster, companies were challenged by the tasks of creating a battery that could sufficiently power a vehicle and a motor that was effective and affordable. Though Tesla was successful in achieving these goals, the price of the Roadster, around \$100,000 at the time of its launch, and the long battery charging times were massive barriers to widespread consumer adoption. Today, Tesla's robust supply chain, including in-house battery cell production, is one of the key contributors to the company's success. Tesla's Gigafactories have enabled the car manufacturer to build economies of scale.

To follow up on the launch of its first EV, Tesla introduced the Model S, the world's first premium all-electric sedan, which was significantly more affordable than the Roadster at \$76,000. It also had the longest driving range of any EV, pushing standards even higher. That same year, Tesla introduced its first freestanding charging stations called Superchargers. Now, there are more than 16,500 Superchargers at more than 1,800 locations. Building on the success of its sedan, Tesla introduced the Model X in 2015, which became the safest SUV ever tested. That same year, Tesla began rolling out an autopilot feature for partial autonomous driving, which enabled the cars to self-drive with active driver supervision.

With three successful vehicle launches under its belt, Tesla began to focus on the energy side of its business, unveiling Solar Roof solar tiles as well as Powerwall and Powerpack industry batteries to store converted solar energy. The company changed its name from Tesla Motors to Tesla, Inc., in 2017, signifying the company's shift from a car manufacturer to a sustainable energy solution company. Tesla's energy solutions enable homeowners, businesses, and utilities to manage renewable energy generation, storage, and consumption.

Tesla introduced the Model 3 in 2017, its most affordable vehicle yet, starting at \$70,000. By 2018, the Model 3 had become the number-one-selling plug-in car in the world, surpassing the Nissan Leaf. To address more of the consumer market, Tesla unveiled its first compact crossover, the Model Y, and a new kind of pickup truck, the Cybertruck, in 2019. The Cybertruck marks Tesla's first attempt to gain credibility in the light-duty pickup truck market.

In addition to addressing more of the consumer market, Tesla is investing in heavy-duty trucks and high-passenger-density urban transport. For example, Tesla Semi, an electric semi-trailer truck, is designed to save owners at least \$200,000 over a million miles based on fuel costs alone. The truck accelerates faster than a traditional semi and can drive faster uphill. Plus, the Semi includes safety features such as Enhanced Autopilot to help truck drivers avoid collisions. Working to cover more forms of transport greatly expands Tesla's footprint and improves the carbon footprint of the transportation industry as a whole.

Tesla is always looking to the future. The automaker—which announced plans for a proprietary app store to introduce games and productivity tools—is hard at work building an ecosystem for its products. This forward-looking strategy puts Tesla's cars years ahead of the competition in terms of value and benefits. The company has made significant gains and has firmly established itself as a leader in EVs.⁴⁹

Critical Thinking Questions

1. What benefits do Tesla's products provide?
2. As competition grows, do you think demand for Tesla's vehicles will decline? Why or why not?
3. How has Tesla pushed the car industry forward?

Team Exercise

Major economic systems, including capitalism, socialism, and communism, as well as mixed economic systems were discussed in this chapter. Assuming that you want an economic system that is best for the majority, not just a few members

of society, defend one of the economic systems as the best system. Form groups and try to reach an agreement on one economic system. Defend why you support the system that you advance.

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