

BUSINESS FOUNDATIONS

A Changing World

Eleventh Edition

O.C. Ferrell | Geoffrey Hirt | Linda Ferrell

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Business Foundations

A Changing World

eleventh edition

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BUSINESS FOUNDATIONS: A CHANGING WORLD, ELEVENTH EDITION

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Dedication

To James Ferrell

To Linda Hirt

To George Ferrell

Authors

O.C. FERRELL



O.C. Ferrell is the James T. Pursell, Sr. Eminent Scholar in Ethics and Director of the Center for Ethical Organizational Cultures in the Raymond J. Harbert College of Business,

Auburn University. He was formerly Distinguished Professor of Leadership and Business Ethics at Belmont University. He has also been on the faculties of the University of Wyoming, Colorado State University, University of Memphis, Texas A&M University, Illinois State University, and Southern Illinois University. He received his PhD in marketing from Louisiana State University.

Dr. Ferrell is president-elect of the Academy of Marketing Science. He is past president of the Academic Council of the American Marketing Association and chaired the American Marketing Association Ethics Committee. Under his leadership, the committee developed the AMA Code of Ethics and the AMA Code of Ethics for Marketing on the Internet. In addition, he is a former member of the Academy of Marketing Science Board of Governors and is a Society of Marketing Advances and Southwestern Marketing Association Fellow and an Academy of Marketing Science Distinguished Fellow. He has served for nine years as the vice president of publications for the Academy of Marketing Science. In 2010, he received a Lifetime Achievement Award from the Macromarketing Society and a special award for service to doctoral students from the Southeast Doctoral Consortium. He received

the Harold Berkman Lifetime Service Award from the Academy of Marketing Science and, more recently, the Cutco Vector Distinguished Marketing Educator Award from the Academy of Marketing Science.

Dr. Ferrell has been involved in entrepreneurial engagements, co-founding Print Avenue in 1981, providing a solution-based printing company. He has been a consultant and served as an expert witness in legal cases related to marketing and business ethics litigation. He has conducted training for a number of global firms, including General Motors. His involvement with direct selling companies includes serving on the Academic Advisory Committee and as a fellow for the Direct Selling Education Foundation.

Dr. Ferrell is the co-author of 20 books and more than 100 published articles and papers. His articles have been published in the *Journal of Marketing Research*, *Journal of Marketing*, *Journal of Business Ethics*, *Journal of Business Research*, *Journal of the Academy of Marketing Science*, *AMS Review*, and the *Journal of Public Policy & Marketing*, as well as other journals.

GEOFFREY A. HIRT



Geoffrey A. Hirt of DePaul University previously taught at Texas Christian University and Illinois State University, where he was chairman of the Department of Finance and

Law. At DePaul, he was chairman of the Finance Department from 1987 to 1997 and held the title of Mesirow Financial Fellow. He developed the

MBA program in Hong Kong and served as director of international initiatives for the College of Business, supervising overseas programs in Hong Kong, Prague, and Bahrain and was awarded the Spirit of St. Vincent DePaul award for his contributions to the university. Dr. Hirt directed the Chartered Financial Analysts (CFA) study program for the Investment Analysts Society of Chicago from 1987 to 2003. He has been a visiting professor at the University of Urbino in Italy, where he still maintains a relationship with the economics department. He received his PhD in finance from the University of Illinois at Champaign-Urbana, his MBA at Miami University of Ohio, and his BA from Ohio Wesleyan University.

Dr. Hirt is currently on the Dean's Advisory Board and Executive Committee of DePaul's School of Music. The Tyree Foundation funds innovative education programs in Chicago, and Dr. Hirt also serves on the Grant Committee. Dr. Hirt is past president and a current member of the Midwest Finance Association, a former editor of the *Journal of Financial Education*, and also a member of the Financial Management Association. He belongs to the Pacific Pension Institute, an organization of public pension funds, private equity firms, and international organizations such as the Asian Development Bank, the IMF, and the European Bank for Reconstruction and Development.

Dr. Hirt is widely known for his textbook *Foundations of Financial Management*, published by McGraw-Hill/Irwin. This book, in its sixteenth edition, has been used in more than 31 countries and translated into more than 14 different languages. Additionally, Dr. Hirt is well known for his textbook *Fundamentals of Investment Management*, also published by McGraw-Hill/Irwin and now in its tenth edition. Dr. Hirt enjoys golf, swimming, music, and traveling with his wife, who is a pianist and opera coach.

LINDA FERRELL



Linda Ferrell is Professor and Chair of the Marketing Department in the Raymond J. Harbert College of Business, Auburn University. She was formerly Distinguished Professor of Leadership and Business Ethics at Belmont University. She completed her PhD in business administration, with a concentration in management, at the University of Memphis. She has taught at the University of Tampa, Colorado State University, University of Northern Colorado, University of Memphis, University of Wyoming, and the University of New Mexico. She has also team-taught classes at Thammasat University in Bangkok, Thailand.

Her work experience as an account executive for McDonald's and Pizza Hut's advertising agencies supports her teaching of advertising, marketing management, marketing ethics, and marketing principles. She has published in the *Journal of Public Policy & Marketing*, *Journal of Business Research*, *Journal of the Academy of Marketing Science*, *Journal of Business Ethics*, *AMS Review*, *Journal of Academic Ethics*, *Journal of Marketing Education*, *Marketing Education Review*, *Journal of Teaching Business Ethics*, *Marketing Management Journal*, and *Case Research Journal*, and she is co-author of *Business Ethics: Ethical Decision Making and Cases* (eleventh edition), *Management* (third edition), and *Business and Society* (sixth edition).

Dr. Ferrell is the immediate past president of the Academy of Marketing Science and a past president for the Marketing Management Association. She is a member of the NASBA Center for the Public Trust Board, on the Mannatech Board of Directors, and on the college advisory board for Cutco/Vector. She is also on the Board, Executive Committee, and Academic Advisory Committee of the Direct Selling Education Foundation. She has served as an expert witness in cases related to advertising, business ethics, and consumer protection.

Welcome

The eleventh edition represents a complete and comprehensive revision. This is because so many events and changes in the environment relate to the foundational concepts in business. This means that an introduction to business product has to provide adequate coverage of dynamic changes in the economy as they relate to business decisions. We have listened to your feedback and incorporated needed changes in content, boxes, cases, exercises, support, online resources and other features.

This is our fourth edition with a chapter on digital marketing and social networking in business. Since launching this chapter in the eighth edition, this dynamic area continues to change the face of business. Entrepreneurs and small businesses have to be able to increase sales and reduce costs by using social networking to communicate and develop relationships with customers. The sharing, or “gig,” economy is transforming entrepreneurial opportunities for employees. For example, the number of independent contractors in our economy has increased from slightly over 5 percent to almost 16 percent of the workforce. The Internet is providing opportunities for peer-to-peer relationships for companies such as Uber, Lyft, TaskRabbit, as well as health care services like Dose. Because this area is a moving target, we have made substantial changes to the eleventh edition of Chapter 13, Digital Marketing and Social Networking. Digital marketing has helped many entrepreneurs launch successful businesses.

Throughout the product, we recognize the importance of sustainability and “green” business. By using the philosophy *reduce, reuse, and recycle*, we believe every business can be more profitable and contribute to a better world through green initiatives. There is a new “Going Green” box in each chapter that covers these environmental changes. Our “Entrepreneurship in Action” boxes also discuss many innovations and opportunities to use sustainability for business success. Sustainability is not only a goal of many businesses, but it is also providing career opportunities for many of our students.

We have been careful to continue our coverage of global business, ethics and social responsibility, and information technology as they relate to the foundations important in an introduction to business course. Our co-author team has a diversity of expertise in these important areas. O.C. Ferrell and Linda Ferrell have been recognized as leaders in business ethics education, and their insights are reflected in every chapter and in the “Consider Ethics and Social Responsibility” boxes. In addition, the website, <http://danielsethics.mgt.unm.edu/> provides free resources such as PowerPoints and cases that can be used in the classroom. Geoff Hirt has a strong background in global business development, especially world financial markets and trade relationships.

The foundational areas of introduction to business, entrepreneurship, small business management, marketing, accounting, and finance have been completely revised. Examples have been provided to which students can easily relate. An understanding

of core functional areas of business is presented so students get a holistic view of the world of business. Box examples related to “Responding to Business Challenges,” “Entrepreneurship in Action,” “Going Green,” and “Consider Ethics and Social Responsibility” help provide real-world examples in these areas.

Our goal is to make sure that the content and teaching package for this book are of the highest quality possible. We wish to seize this opportunity to gain your trust, and we appreciate any feedback to help us continually improve these materials. We hope that the real beneficiary of all of our work will be well-informed students who appreciate the role of business in society and take advantage of the opportunity to play a significant role in improving our world. In this new edition, we have additional content to help our students understand how our free enterprise system operates and how we fit into the global competitive environment. This course is an opportunity for students to understand how they can create their own success and improve their quality of life.

O.C. Ferrell
Geoffrey A. Hirt
Linda Ferrell

Focused, Exciting, Applicable, Happening

Business Foundations: A Changing World, eleventh edition, offers faculty and students a **focused** resource that is **exciting, applicable, and happening!** What sets this learning program apart from the competition? An unrivaled mixture of exciting content and resources blended with application focused text and activities, and fresh topics and examples that show students what is happening in the world of business today!

Our product contains all of the essentials that most students should learn in a semester. *Business Foundations* has, since its inception, delivered a focused presentation of the essential material needed to teach introduction to business. An unrivaled mixture of exciting content and resources, application-focused content and activities, and fresh topics and examples that show students what is happening in the world of business today set this text apart!

○ Focused!

It's easy for students taking their first steps into business to become overwhelmed. Longer products try to solve this problem by chopping out examples or topics to make ad hoc shorter editions. *Business Foundations* carefully builds just the right mix of coverage and applications to give your students a firm grounding in business principles. Where other products have you sprinting through the semester to get everything in, Ferrell/Hirt/Ferrell allows you the breathing space to explore topics and incorporate other activities that are important to you and your students. The exceptional resources and the *Active Classroom Resource Manual* support you in this effort every step of the way.

⊖ **Exciting**

It's exciting to see students succeed! It's exciting to see more As and Bs in a course without grade inflation. Ferrell/Hirt/Ferrell makes these results possible for your course with its integrated learning package that is proven effective, tailored to each individual student, and easy to use.

⊖ **Applicable**

When students see how content applies to them, their life, their career, and the world around them, they are more engaged in the course. *Business Foundations* helps students maximize their learning efforts by setting clear objectives; delivering interesting cases and examples; focusing on core issues; and providing engaging activities to apply concepts, build skills, and solve problems.

⊖ **Happening!**

Because it isn't tied to the revision cycle of a larger book, *Business Foundations* inherits no outdated or irrelevant examples or coverage. Everything in the eleventh edition reflects the very latest developments in the business world—from the recent recession, high unemployment rates, and the financial instability in Europe to the growth of digital marketing and social networking. In addition, ethics continues to be a key issue, and Ferrell/Hirt/Ferrell use “Consider Ethics and Social Responsibility” boxes to instill in students the importance of ethical conduct in business. To ensure you always know what's happening, join the author-led Facebook group page supporting this text.



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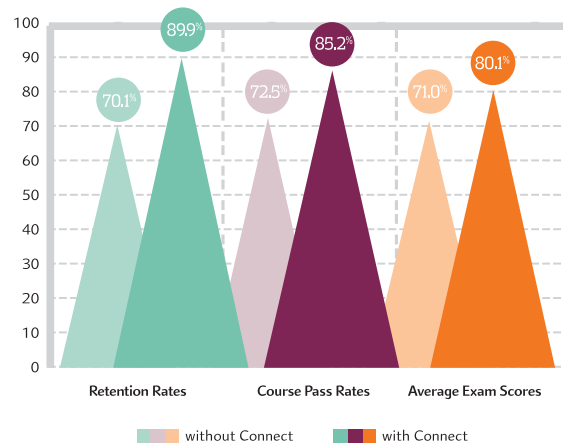
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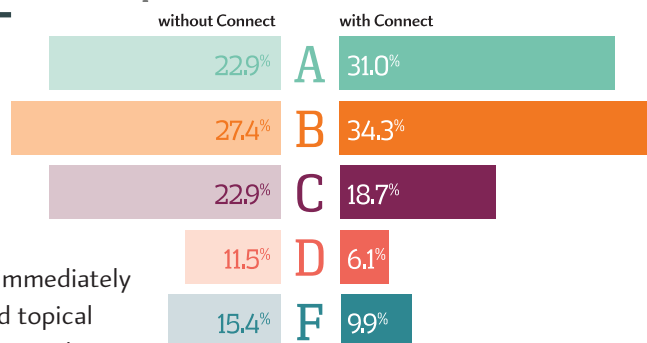
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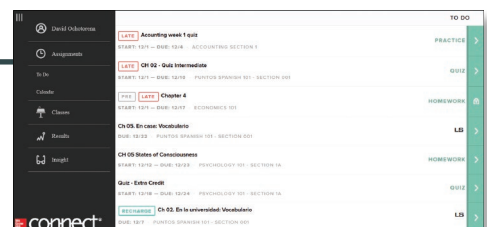
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New to This Edition

As always, when revising this material for the current edition, all examples, figures, and statistics have been updated to incorporate any recent developments that affect the world of business. Additionally, content was updated to ensure the most pertinent topical coverage is provided. We now provide bonus chapters in the text—Bonus Chapter A, The Legal and Regulatory Environment, and Bonus Chapter B, Personal and Financial Planning—to meet market demands. In addition, we have added a new online Appendix C, which provides the basics of risk management. Both insurable and noninsurable risk are covered in this appendix.

Here are the highlights for each chapter:

Chapter 1: The Dynamics of Business and Economics

- New boxed features describing real-world business issues
- New material on standard of living
- A new section on “The Importance of the American Economy”

Chapter 2: Business Ethics and Social Responsibility

- New boxed features describing issues in business ethics and social responsibility
- New examples of ethical issues facing today’s businesses
- New *See for Yourself Videocase*—Warby Parker

Chapter 3: Business in a Borderless World

- New boxed features describing issues in international business
- New *See for Yourself Videocase*—Electra Bikes

Chapter 4: Options for Organizing Business

- New boxed features describing real-world business issues
- New definition of a master limited partnership
- New information on nonprofit organization

Chapter 5: Small Business, Entrepreneurship, and Franchising

- New boxed features describing current business issues
- New section on the sharing economy
- New material on nonstore retailing
- New information on incubators

Chapter 6: The Nature of Management

- New boxed features describing current business issues
- Staffing has been removed as a function of management, and the information on staffing has been moved toward the introduction
- New definition of brainstorming
- New information on participative decision making
- New *See for Yourself Videocase*—Panera Bread

Chapter 7: Organization, Teamwork, and Communication

- New boxed features describing current business issues
- A new objective on organizational culture
- New figure describing desired attitudes and behaviors associated with corporate culture

- New “Did You Know?” feature
- Information on formal communication has been placed in a table
- New *See for Yourself Videocase*—Hot Topic

Chapter 8: Managing Service and Manufacturing Operations

- New boxed features describing current business operational issues
- New material on the role of drones in operations
- New information on ISO 19600 related to compliance

Chapter 9: Motivating the Workforce

- New boxed features describing current business issues
- New section on goal-setting theory
- Updated information on best places for businesses and careers
- Definition of reinforcement theory

Chapter 10: Managing Human Resources

- New boxed features describing current HR issues
- A new “Did You Know?” feature
- New information on micropreneurs
- New information on exit interviews
- New material on mentoring employees
- New figure on recruiters’ use of social networking in the recruitment process

Chapter 11: Customer-Driven Marketing

- New boxed features describing current marketing issues
- New material on marketing analytics
- New information on benefit segmentation
- New material on B2B marketing
- New *See for Yourself Videocase*—Marriott

Chapter 12: Dimensions of Marketing Strategy

- New boxed features describing current marketing issues
- New definition of merchant wholesalers
- Direct selling and direct marketing added as key terms
- New *See for Yourself Videocase*—Spirit Airlines

Chapter 13: Digital Marketing and Social Networking

- New boxed features describing current digital marketing issues
- New information on illicit activities conducted on the Internet
- New information on virtual gaming

Chapter 14: Accounting and Financial Statements

- New boxed features describing current accounting issues
- New information on the financial information and ratios of Microsoft
- Financial ratio comparisons of Microsoft and Google

Chapter 15: Money and the Financial System

- New boxed features describing current financial issues
- New material on reward cards
- New *See for Yourself Videocase*—State Farm

Chapter 16: Financial Management and Securities Markets

- New boxed features describing current financial issues
- New *See for Yourself Videocase*—Tom and Eddie’s

Acknowledgments

The eleventh edition of *Business Foundations: A Changing World* would not have been possible without the commitment, dedication, and patience of Jennifer Sawayda and Julian Mathias. Jennifer Sawayda provided oversight for editing and developing text content, cases, boxes, and the supplements. Julian Mathias assisted in developing many of the boxes in this edition. Anke Weekes, Executive Brand Manager, provided leadership and creativity in planning and implementing all aspects of the eleventh edition. Gabriela G. Velasco, Product Developer, did an outstanding job of coordinating all aspects of the development and production process. Sheila Frank was the Content Project Manager. Evan Roberts managed the technical aspects of Connect. Others important in this edition include Michael Gedatus (Senior Marketing Manager) and Debra Kubiak (Designer). Michael Hartline developed the Personal Career Plan in Appendix B. Vickie Bajtelsmit developed Bonus Chapter B on personal financial planning. Eric Sandberg of Interactive Learning assisted in developing the interactive exercises. Many others have assisted us with their helpful comments, recommendations, and support throughout this and previous editions. Thank you for all of your insight and feedback. We'd like to express our sincere thanks to the reviewers who helped us shape the eleventh edition. Your time and thoughtful feedback has helped us greatly make this another great revision:

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B. Personal Career Plan

C. Risk: The Basics of Risk Management



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



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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

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, and profit.

LO 1-2

Identify the main participants and activities of business and explain why studying business is important.

LO 1-3

Define economics and compare the four types of economic systems.

LO 1-4

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

LO 1-5

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

LO 1-6

Trace the evolution of the American economy and discuss the role of the entrepreneur in the economy.

LO 1-7

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

Enter the World of Business

Dollar Shave Club Cuts through the Competition

For Dollar Shave Club (DSC), it's all about finding a better and more convenient way to meet the demand for razor blades. The idea for the firm emerged from a conversation entrepreneur Michael Dubin was having with co-founder Mark Levine about the annoyances of shaving. They found it inconvenient and costly to have to purchase multiple brand-name blades each month. This conversation resulted in the concept for a subscription-based service. Consumers who become members of DSC are mailed razor blades for as little as \$1 per month.

The razor blade market is an example of monopolistic competition. The market is relatively easy to enter because the products are low tech, low cost, and easy to manufacture. Still, it is dominated by a few major brands, most notably Gillette and Schick. Gillette has 60 percent of the retail market. This meant that in order to compete against Gillette, DSC had to find a way to differentiate its product offering from rivals'. For DSC, the answer was not so much in the razor blade, but in the convenience and price savings offered to the consumer. Customers are paying for the service of having razor blades delivered to their door without the hassle or expense of purchasing them in a store. It also differentiates its business through its promotional techniques, most notably its humorously crafted, low-cost videos released on YouTube.

Gillette has taken notice. It has created its own shave club where consumers can order online. Other online competitors to DSC have also cropped up, including 800Razors LLC and Harry's Razor Co. For DSC to compete effectively, it is looking for further ways to "own the men's bathroom" with innovative products that meet customer needs. In 2016 Unilever purchased DSC for \$1 billion.¹

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, and profit.

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** tries to earn a profit by providing products that satisfy people's needs. The outcomes of its efforts are **products** that have both tangible and intangible characteristics that provide satisfaction and benefits. When you purchase a product, you are buying the benefits and satisfaction you think the product will provide. A Subway sandwich, for example, may be purchased to satisfy hunger, while a Honda Accord 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, coat, 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 checkup by a doctor, a movie or sports event—these are examples of services. Some services, such as Instagram, a mobile photo management and sharing application, do not charge a fee for use but obtain revenue from ads on their sites. A product can also be an idea. Accountants and attorneys, for example, generate ideas for solving problems.

The Goal of Business

The primary goal of all businesses is to earn a **profit**, the difference between what it costs to make and sell a product and what a customer pays for it. If a company spends \$8.00 to manufacture, finance, promote, and distribute a product that it sells for \$10.00, the business earns a profit of \$2.00 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 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 a responsible manner. 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. Profits earned by businesses support nonprofit organizations through donations from employees.

To earn a profit, a person or organization needs 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. Other challenges for businesspeople include abiding by laws and government regulations; acting in an ethical and socially responsible manner; and adapting to economic, technological, political, and social changes. Even nonprofit organizations engage in management, marketing, and finance activities to help reach their goals.

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. New fuel requirements are forcing automakers to invest in smaller, lightweight cars. During times of low fuel prices, consumers tend to prefer bigger SUVs and trucks, putting more of a strain on automakers to meet environmental requirements as well as consumer demands.² Others are concerned with promoting science, engineering, and mathematics careers among women. Traditionally, these careers have been male dominated. The Association for Women in Science focuses on helping women reach their full potential in these underrepresented fields.³ Other companies, such as Home Depot, have a long history of supporting natural disaster victims, relief efforts, and recovery.



Sustainability is a growing concern among both consumers and businesses. Walmart has invested in solar panels at some of its stores to decrease its energy usage.

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

The People and Activities of Business

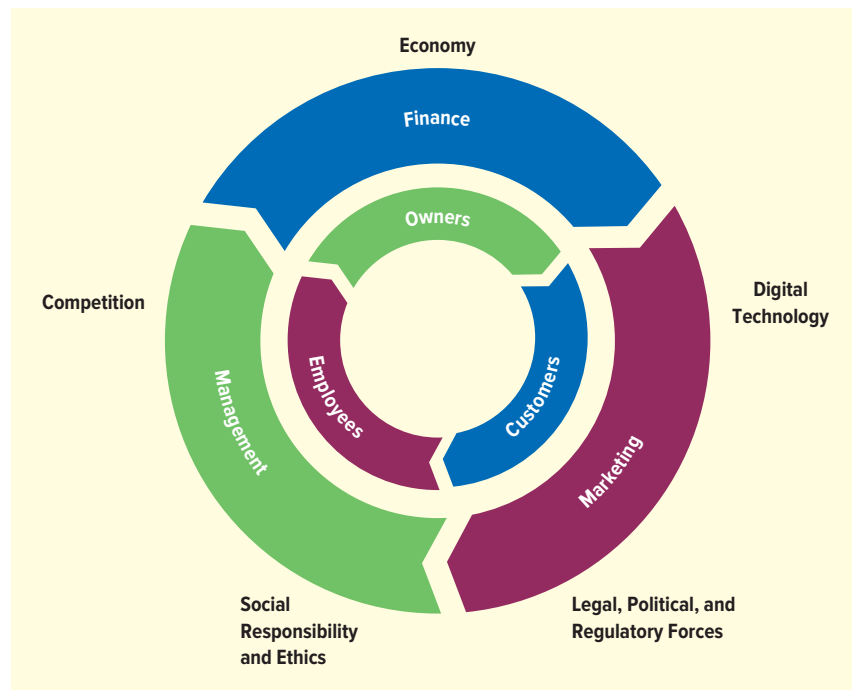
Figure 1-1 shows the people and activities involved in business. At the center of the figure are owners, employees, and customers; the outer circle includes the primary business activities—management, marketing, and finance. Owners have to put up resources—money or credit—to start a business. Employees 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 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 people and 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 involves the functions of planning, organizing, leading, and controlling. Effective managers who are skilled in these functions display effective leadership, decision making, and implementation of work tasks. Management is also concerned with acquiring, developing, and using resources (including people) effectively and efficiently. For instance, managers at Hewlett-Packard made the strategic decision to split into two companies. Years of declining sales and corporate scandals convinced them that the firm needed to be smaller and more flexible to compete.⁴

LO 1-2

Identify the main participants and activities of business and explain why studying business is important.

FIGURE 1-1
Overview of the Business
World



Operations is another element of management. Managers must oversee the firm's operations to ensure that resources are successfully transformed into goods and services. Although most people associate operations with the development of goods, operations management applies just as strongly to services. 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 consumers 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 see if products need to be modified. Marketing focuses on the four P's—product, price, place (or distribution), and promotion—also known as the marketing mix. Product management involves such key management decisions as product adoption or deletion, branding, and product positioning. Selecting the right price for the product is essential to the organization as it relates directly to profitability. Distribution 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 increase sales. We will examine marketing activities in Part 5 of this text.



The Aflac duck ad uses humor in its advertising to promote the insurance company.

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Finance. Owners and finance are in the same part of 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. Moreover, the owners have the most to lose if the business fails to make a profit. Finance refers to all activities concerned with obtaining money and using it effectively. People who work as accountants, stockbrokers, investment advisors, or bankers are all part of the financial world. Owners sometimes have to borrow money from banks to get started or attract additional investors who become partners or stockholders. Owners of small businesses in particular often rely on bank loans for funding. Part 6 of this text discusses financial management.

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 multinational *Fortune* 500 firm, 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 and operations, wholesaling and retailing, and many more.

Studying business can also help you better understand the many business activities that are necessary to provide satisfying goods and services—and that these activities carry a price tag. For example, if you buy a new DVD or Blu-ray disc, about half of the price goes toward activities related to distribution and the retailer's expenses and profit margins. The production (pressing) of the disc represents about \$1, or a small percentage of its price. 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. Bill Daniels founded Cablevision, building his first cable TV system in Casper, Wyoming, in 1953, and is now considered “the father of cable

television.” Prior to Daniels’ passing in 2000, he had established a foundation that currently has funding significantly over \$1 billion and supports a diversity of causes from education to business ethics. During his career, Daniels created the Young Americans Bank, where children could create bank accounts and learn about financial responsibility, and this remains the world’s only charter bank for young people. He named the Daniels College of Business through a donation of \$20 million to the University of Denver. During his life, he affected many individuals and organizations, and his business success has allowed his legacy to be one of giving and impacting communities throughout the United States.⁵ Most of the profits he earned in business continue to support nonprofit organizations and society. Thus, learning about business can help you become a well-informed consumer and member of society.

Business activities help generate the profits that are essential not only to individual businesses and local economies but also to the health of the global economy. Without profits, businesses find it difficult, if not impossible, to buy more raw materials, hire more employees, attract more capital, and create additional products that in turn make more profits and fuel the world economy. Understanding how our free-enterprise economic system allocates resources and provides incentives for industry and the workplace is important to everyone.

LO 1-3

Define economics and 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

the physical and mental abilities that people use to produce goods and services; also called labor.

financial resources (capital)

the funds used to acquire the natural and human resources needed to provide products; also called capital.

economic system

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

The Economic Foundations of Business

To continue our introduction to 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, as we shall see.

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 consumers’ 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.

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.



China has a communist economic system and is one of the largest economies in the world.

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

	Communism	Socialism	Capitalism
Business ownership	Most businesses are owned and operated by the government.	The government owns and operates some major industries; individuals own small businesses.	Individuals own and operate all businesses.
Competition	Government controls competition and the economy.	Restricted in major industries; encouraged in small business.	Encouraged by market forces and government regulations.
Profits	Excess income goes to the government. The government supports social and economic institutions.	Profits earned by small 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 some 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.

TABLE 1-1
Comparison of
Communism, Socialism,
and Capitalism