chapter

2

The Environment of Business

After reading this chapter, you should be able to:

LO-1 Explain the concepts of *organizational boundaries* and *multiple organizational environments*.

LO-2 Explain the importance of the *economic environment* to business and identify the factors used to evaluate the performance of an economic system.

LO-3 Describe the *technological environment* and its role in business.

LO-4 Describe the *political–legal environment* and its role in business.

LO-5 Describe the *socio-cultural environment* and its role in business.

LO-6 Identify emerging challenges and opportunities in the *business environment*.

LO-7 Understand recent trends in the *redrawing of corporate boundaries*.

SCANLIFE

Air Canada's Challenging Environment: Competition, Economic Crisis, Fuel Prices, Volcanoes, and More

The name Air Canada does not always conjure up warm images for Canadian travellers. But it is the fifteenth largest airline in the world and it wins international awards. In 2010, it was named the "best airline in North America" by independent research firm Skytrax (which surveyed over 17 million world-wide travellers). There have been many ups and downs for Air Canada, but the company continues to control the majority of the domestic market, with WestJet as its main competitor. Back in 2004, Air Canada used bankruptcy protection to deal with major financial problems. It may be tempting to blame that dark period on general turmoil in the travel industry, following the 9/11 terrorist attacks, but placing all the blame on that significant event would be overly simplistic. The airline business is always extremely complicated; it's a difficult business environment that is shaped by relationships with many stakeholders.

Airlines must efficiently plan their capacity. They don't buy a fleet of planes overnight; airlines make projections and try to maximize the use of planes and other resources. Some of this planning is done two to five or even seven years into the future and this sort of lengthy timeline is complicated. Air Canada must contend with *competitor actions* (e.g., WestJet, Porter) at home, and on

How Will This Help Me?

By understanding the material in this chapter, you'll be better able to assess (1) the impact that events outside a business can have on its *owners* and *managers*, (2) how environmental change impacts you as a *consumer*, and (3) the challenges and opportunities that environmental change provides to you as an employee or an *investor*.

international routes (e.g., Air France, British Airways, JAL); it must deal with government regulations (e.g., tax laws, flight restrictions, and international agreements), economic conditions (e.g., recessions, fuel/food prices), and natural weather conditions (e.g., snowstorms and even volcanic ash). Let's take a closer look at these challenges.

In recent years, a major spike in fuel costs hurt air travel and caused ticket prices to skyrocket at times. The global recession, which started in 2008, decreased tourist and business travel. In fact, in 2009 the global airline business saw its most steep decline in air traffic since the Second World War. According to the International Air Transport Association (IATA), the global industry lost $10 billion that year, with additional losses expected in the $3 billion range in 2010. Air Canada worked hard to get its finances under control by creating new agreements with suppliers and major credit providers. However, in the first quarter of 2010, the airline still had an operating loss of $138 million (Air Canada pointed out that this was an improvement from the $188 million loss a year earlier indicated in the first quarter).

At home, Air Canada competes with WestJet and a host of smaller players. The rivalry has pushed it to launch its lower priced Tango fares to compete in the low-frill, budget travel segment. In addition, the company created a regional partner called Jazz mainly for short-haul flights. In order to effectively compete on the global stage Air Canada has forged alliances to cut costs. It is a founding member of the leading airline network called Star Alliance. These 26 members permit passengers on partner airlines to connect with over 1100 airports in 175 countries. The airlines code-share flights (e.g., booking Air Canada seats on a Lufthansa flight) and share airline lounges in airports around the world. In 2009, Air Canada also extended its partnerships with Continental, United, and Lufthansa to create Atlantic-Plus-Plus, which further enables it to integrate routes and compete in the transatlantic segment.

Governments are strongly linked to airline success or failure. Here are some key facts to consider. The government recently negotiated an agreement between Canada and the EU that created new opportunities by reducing restrictions for Air Canada and EU airlines. So in 2010, Air Canada launched new direct services to five popular European gateway cities: Geneva, Barcelona, Brussels, Copenhagen, and Athens. A similar deal with the United States government back in 1995 was an important step in Air Canada's extensive expansion (Air Canada is the largest airline in the U.S.–Canada trans-border market, serving 60 destinations in the U.S.). Of course, the relationship with the government is not all rosy. Air Canada has stated that the government is making it impossible for the airline to be profitable with higher security charges, airport improvement fees, and federal and provincial fuel excise taxes. For example, the federal government collects over $300 million in rent from airports each year. This makes it much more expensive to land a plane in Canada than in the U.S. Air Canada pays $3400 to land an Airbus 320 in Canada's largest airports but less than half that amount ($1650) in the U.S. Total federal tax collected in Halifax alone amounted to $3.2 million in rent charges in 2009 and is expected to top $5 million by 2014. Since the airline is based in Canada, it has a tax cost disadvantage.

Weather can play a tricky role in airline operations. If you travel on a regular basis you are very familiar with airline delays. Snowstorms, severe thunder showers, icy weather, and severe winds can disrupt travel and cause delays. This creates frustrated passengers and forces airline employees and travel agents to scramble. In April 2010, a new issue hit the headlines when a volcano in Iceland halted all air travel to and from Europe for five long days, cancelling over 100 000 flights. The name of the volcano is Eyjafjallajokull (pronounced ay-yah-FYAH-lah-yer-kuhl), and customers were heard muttering similar sounds as they tried to get home. It cost the airline industry huge sums of money through no fault of its own. Air Canada lost $20 million per day; Air Transat lost approximately $750 000 per day; Air France-KLM lost an estimated $35 million per day. Airlines demanded compensation from the EU for more than $1 billion in losses. It remains to be seen what the ultimate response will be.

As you can see, airlines must create efficient strategies and plan for the unexpected. But there are so many elements far outside their control that impact success or failure. In addition to the issues mentioned above, there are the massive new security challenges, flu pandemics, and political conflict (e.g., civil war) that can erupt anywhere in the world. This is why it is so hard to find an airline that is profitable on a consistent basis. This is truly a challenging industry.

LO-1 Organizational Boundaries and Environments

As discussed in the opening case on Air Canada, all businesses, regardless of their size, location, or mission, operate within a larger external environment that plays a major role in determining their success or failure. The **external environment** consists of everything outside an organization that might affect it. Managers must understand the key features of the external environment, and then strive to operate and compete within it. No single firm can control the environment, but managers should not simply react to changes in the external environment; rather, they should be proactive and at least try to influence their environment.

To better explain the environment of business, we begin by discussing *organizational boundaries* and *multiple organizational environments*.

Organizational Boundaries

An **organizational boundary** separates the organization from its environment. Consider the simple case of a small neighbourhood grocery store that includes a retail customer area, a storage room, and the owner/manager's office. In many ways, the store's boundary coincides with its physical structure: When you walk through the door, you're crossing the boundary into the business, and when you go back onto the sidewalk, you cross the boundary back into the environment. But this is an oversimplification. During the business day, distributors of soft drinks, snack foods, ice, and bread products may enter the store, inventory their products, and refill coolers and shelves just as if they were employees. These distributors are normally considered part of the environment rather than the organization, but during the time they're inside the store, they are essentially part of the business. Customers may even assume that these distributors are store employees and ask them questions as they restock shelves.

For larger firms, the situation is even more complex. McDonald's, for example, has a contract with Coca-Cola to sell only Coke soft-drink products. McDonald's also has partnerships with Walmart and Disney that allow it to open stores inside their facilities. So when you buy a Coca-Cola soft drink from a McDonald's restaurant located inside a Walmart store or Disney theme park, you are essentially affecting, and being affected by, multiple businesses.

Multiple Organizational Environments

Organizations have multiple environments. Some, like prevailing economic conditions, affect the performance of almost every business. But other dimensions of the environment are much more specific. The neighbourhood grocery store, for example, will be influenced not only by an increase in unemployment in its area but also by the pricing and other marketing activities of its nearest competitors. As we saw in the opening case, Air Canada will be affected by competitive pressures from WestJet, from the general economic conditions (like unemployment levels and business confidence), and even from major global events like the volcanic ash that caused 100 000 flight cancellations in Europe.[1]

Figure 2.1 shows the major elements of the external environment: economic conditions, technology, political–legal considerations, social issues, the global environment, issues of ethical and social responsibility, the business environment itself, and emerging challenges and opportunities. We will cover ethical and global issues in detail in Chapters 3 and 5 respectively, so we discuss them here only as they relate directly to the other areas in this chapter.

EXTERNAL ENVIRONMENT Everything outside an organization's boundaries that might affect it.

ORGANIZATIONAL BOUNDARY That which separates the organization from its environment.

ECONOMIC ENVIRONMENT Conditions of the economic system in which an organization operates.

LO-2 The Economic Environment

The **economic environment** refers to the conditions of the economic system in which an organization operates.[2] For example, McDonald's Canadian operations are (as of this writing) functioning in an economic environment characterized by moderate growth, moderate unemployment, and low inflation. Moderate unemployment means that most people can afford to eat out, and low inflation means that McDonald's pays relatively constant prices for its supplies. But it also means that McDonald's can't easily increase the prices it charges because of competitive pressures from Burger King and Wendy's.

Economic Growth

At one time, about half the Canadian population was involved in producing the food that we eat. Today, less than 2.5 percent of the population works in agriculture because agricultural efficiency has improved so much that far fewer people are needed to produce the food we need. We can therefore say that agricultural production has *grown* because the total output of the agricultural sector has increased. We can apply the same idea to a nation's economic system, but the computations are much more complex, as we shall see.

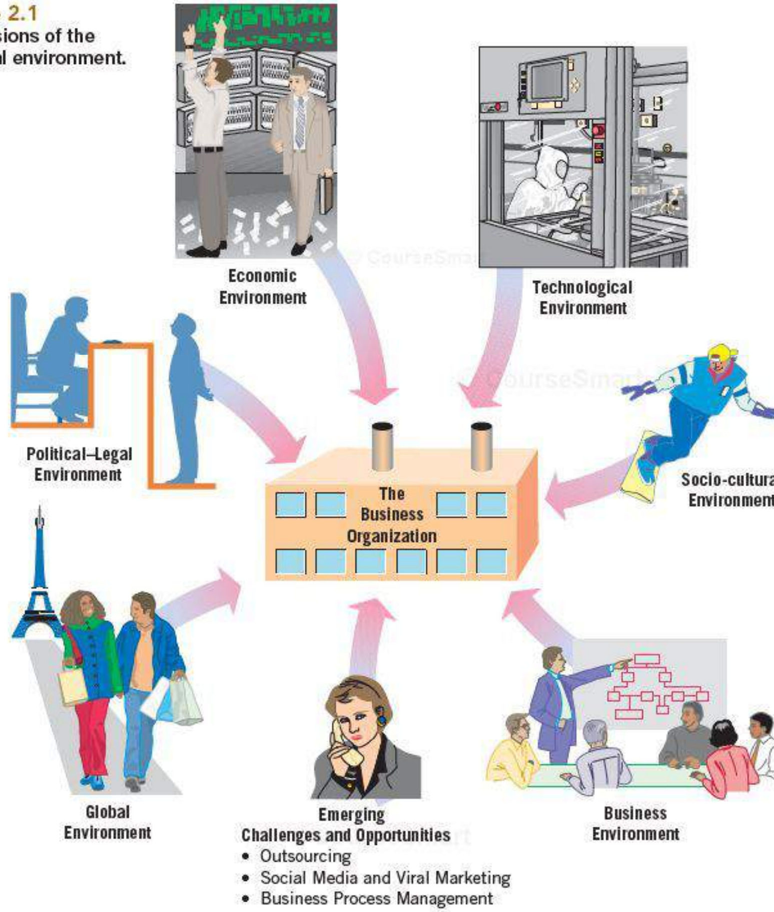
AGGREGATE OUTPUT Total quantity of goods and services produced by an economic system during a given period.

STANDARD OF LIVING Total quantity and quality of goods and services that a country's citizens can purchase with the currency used in their economic system.

BUSINESS CYCLE Pattern of short-term ups and downs (expansions and contractions) in an economy.

GROSS DOMESTIC PRODUCT (GDP) Total value of all goods and services produced within a given period by a national economy through domestic factors of production.

Figure 2.1
Dimensions of the external environment.



Aggregate Output and the Standard of Living

How do we know whether or not an economic system is growing? The main measure of *growth* is **aggregate output:** the total quantity of goods and services produced by an economic system during a given period.[3] To put it simply, an increase in aggregate output is economic growth.[4] When output grows more quickly than the population, two things usually follow: output per capita (the quantity of goods and services per person) goes up and the system provides relatively more of the goods and services that people want.[5] And when these two things occur, people living in an economic system benefit from a higher **standard of living**—the total quantity and quality of goods and services that they can purchase with the currency used in their economic system.

The Business Cycle

The growth (and contraction) pattern of short-term ups and downs in an economy is called the **business cycle.** It has four recognizable phases: peak, recession, trough, and recovery (see Figure 2.2). A **recession** is usually defined as two consecutive quarters when the economy shrinks, but it is probably more helpful to say that a recession starts just after the peak of the business cycle is reached and ends when the trough is reached.[6] A **depression** occurs when the trough of the business cycle extends two or more years. Periods of expansion and contraction can vary from several months to several years. During the latter half of the 1990s, the Canadian economy was continuously expanding, leading some people to believe that the business cycle was a thing of the past. That belief was shattered twice in the last 10 years: in 2000, when the high-tech bubble burst, and in 2008, when a major financial crisis and worldwide recession occurred. Many economists predicted that the most recent recession would be long, and some compared it to the Great Depression of the 1930s.

Gross Domestic Product and Gross National Product

The term **gross domestic product (GDP)** refers to the total value of all goods and services produced within a given period by a national economy through domestic factors of production. If GDP is going up, the nation is experiencing economic growth. Canada's GDP in 2009 was $1.56 trillion.[7]

GDP measures all business activity within a nation's borders and it has widely replaced **gross national product (GNP)**, which refers to the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located. For example, the profits from a Canadian-owned manufacturing plant in Brazil are included in Canadian GNP—but not in GDP—because its output is not produced in Canada. Conversely, those profits are included in Brazil's GDP—but not GNP—because they are produced domestically (that is, in Brazil) but not by a Brazilian company.

Today, GDP is the key measure of economic growth because it tracks an economy's performance over time. However, some argue that such measures are flawed. A commission created by French president Nicolas Sarkozy and chaired by famous economist Joseph Stiglitz declared that our obsession with GDP helped contribute to the strength of the most recent recession. According to the findings, if a bit more attention had been paid to other indicators, like rising debt, governments may have reacted more cautiously. An article in *The Economist* magazine even referred to GDP as "grossly deceptive product."[8] An organization called Redefining Progress has proposed a more realistic measure to assess economic activity—the Genuine Progress Indicator (GPI). GPI treats activities that harm the environment or our quality of life as costs and gives them negative values. For example, in 2010, activities required to clean the mess from the BP Gulf of Mexico oil drilling disaster were included in measurements of economic growth. But the oil spill was not a good thing. The GPI measure shows that while GDP has been increasing for many years, GPI has been falling for over 30 years.[9]

GROSS NATIONAL PRODUCT (GNP) Total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located.

GDP PER CAPITA Gross domestic product per person.

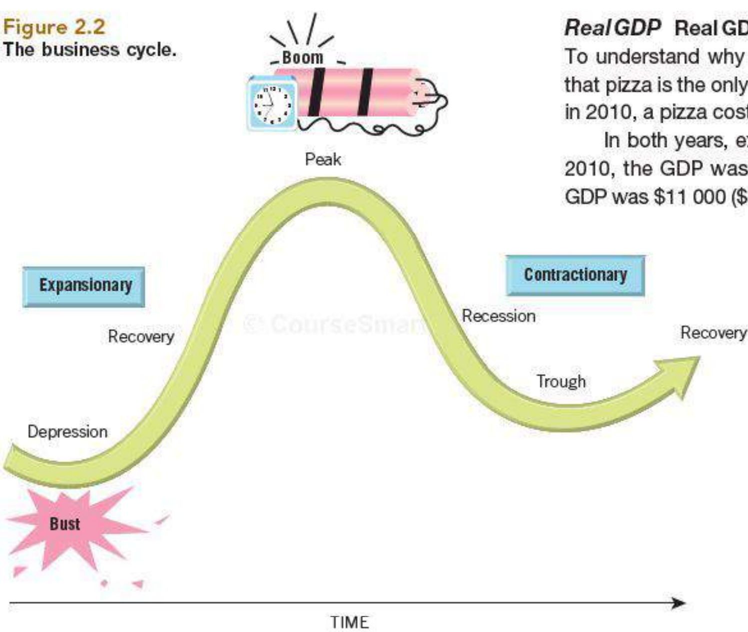
REAL GDP GDP calculated to account for changes in currency values and price changes.

NOMINAL GDP GDP measured in current dollars or with all components valued at current prices.

Real Growth Rates GDP is the preferred method of calculating national income and output. The *real growth rate of GDP*—the growth rate of GDP *adjusted for inflation and changes in the value of the country's currency*—is what counts. Remember that *growth depends on output increasing at a faster rate than population*. If the growth rate of GDP exceeds the rate of population growth, then our standard of living should be improving.

GDP per Capita **GDP per capita** means GDP per person. We get this figure by dividing total GDP by the total population of a country. As a measure of economic well-being of the average person, GDP per capita is a better measure than GDP. Norway has the highest GDP per capita of any country ($40 807), followed by the United States ($38 808), Ireland ($35 306), and Switzerland ($34 440). Canada ranked eighth at ($31 369).[10]

Figure 2.2
The business cycle.



Real GDP **Real GDP** means that GDP has been adjusted. To understand why adjustments are necessary, assume that pizza is the only product in an economy. Assume that in 2010, a pizza cost $10 and in 2011 it cost $11.

In both years, exactly 1000 pizzas were produced. In 2010, the GDP was $10 000 ($10 × 1000); in 2011, the GDP was $11 000 ($11 × 1000). Has the economy grown? No. Since 1000 pizzas were produced in both years, aggregate output remained the same. If GDP is not adjusted for 2011, it is called **nominal GDP**, that is, GDP measured in current dollars.[11]

Purchasing Power Parity In our example, *current prices* would be 2011 prices. On the other hand, we calculate real GDP when we account for *changes in currency values and price changes*. When

PURCHASING POWER PARITY Principle that exchange rates are set so that the prices of similar products in different countries are about the same.

PRODUCTIVITY Measure of economic growth that compares how much a system produces with the resources needed to produce it.

BALANCE OF TRADE The total of a country's exports (sales to other countries) minus its imports (purchases from other countries).

NATIONAL DEBT The total amount of money that a country owes its creditors.

BUDGET DEFICITS The result of the government spending more in one year than it takes in during that year.

we make this adjustment, we account for both GDP and **purchasing power parity**—the principle that exchange rates are set so that the prices of similar products in different countries are about the same. Purchasing power parity gives us a much better idea of what people can actually buy. In other words, it gives us a better sense of standards of living across the globe.

Productivity A major factor in the growth of an economic system is **productivity**, which is a measure of economic growth that compares how much a system produces with the resources needed to produce it. Let's say, for instance, that it takes one Canadian worker and one Canadian dollar to make 10 soccer balls in an eight-hour workday. Let's also say that it takes 1.2 Saudi workers and the equivalent of $1.2 (in riyals, the currency of Saudi Arabia) to make 10 soccer balls in the same eight-hour workday. We can say, then, that the Canadian soccer-ball industry is more *productive* than the Saudi soccer-ball industry.

The two factors of production in this extremely simple case are labour and capital. According to the Organisation for Economic Co-operation and Development (OECD) rankings, Canada stood in sixteenth place with a productivity ratio of 78.2 percent compared to the United States. Luxembourg was the most productive nation at 140.4 percent. Norway (136 percent) and the Netherlands (100.4 percent) were also classified above the benchmark U.S. statistics.[12]

If more products are being produced with fewer factors of production, what happens to the prices of these products? They go down. As a consumer, therefore, you would need less of your currency to purchase the same quantity of these products. Thus, your standard of living—at least with regard to these products—has improved. If your entire economic system increases its productivity, then your overall standard of living improves. In fact, the standard of living improves only through increases in productivity.[13]

The Balance of Trade and the National Debt There are several factors that can help or hinder the growth of an economic system, but here we focus on just two of them: *balance of trade* and the *national debt*.

Balance of Trade The **balance of trade** is the economic value of all the products that a country *exports* minus the economic value of its *imported* products. A negative balance of trade is commonly called a *trade deficit*, and a positive balance of trade is called a *trade surplus*. Canada traditionally has had a positive balance of trade. It is usually a *creditor nation* rather than a debtor nation. For example, Canada received $47 billion more from exports than it spent on imports in 2008, but in 2009 a long trend was reversed when Canada had a trade deficit of $4.8 billion.[14] The United States usually has a negative balance of trade; it spends more on imports than it receives for exports.[15] It is therefore a consistent *debtor nation*. A trade deficit negatively affects economic growth because the money that flows out of a country can't be used to invest in productive enterprises, either at home or overseas.

National Debt A country's **national debt** is the amount of money that the government owes its creditors. Like a business, the government takes in revenues (e.g., taxes) and has expenses (e.g., military spending, social programs). For many years, the government of Canada incurred annual **budget deficits**, that is, it spent more money *each year* than it took in. These accumulated annual deficits have created a huge national debt (estimated above $600 billion by the end of 2010). A typical recession causes an 86 percent increase in the national debt.[16]

From Confederation (1867) to 1981, the *total* accumulated debt was only $85.7 billion, but in the period 1981–1994, *annual deficits* were in the $20- to $40-billion range. But from 1997 to 2008, Canada was the only highly industrialized country in the world that had annual budget surpluses. That all changed in 2009 when the government announced a deficit of $46.9 billion. The good news, if you can call it that, was that this figure was actually 12 percent lower than initially expected.[17] The bad news was that another $49 billion deficit was projected in 2010 as well as $27.6 billion in 2011 and $17.5 billion in 2012.[18] Big increases in annual deficits are also predicted for the United States because of the multibillion-dollar bailouts that were given to companies in the financial sector. In spite of this, the United States is still able to borrow large amounts of money from countries like China because the United States is seen as a strong economy and a safe haven in troubled economic times.[19]

How does the national debt affect economic growth? When the government of Canada sells bonds to individuals and organizations (both at home and overseas), this affects economic growth because the Canadian government competes with every other potential borrower—individuals, households, businesses, and other organizations—for the available supply of loanable money. The more money the government borrows, the less money is available for the private borrowing and investment that increases productivity.

Economic Stability

A key goal of an economic system is **stability**: a condition in which the amount of money available in an economic system and the quantity of goods and services produced in it are growing at about the same rate. Several factors threaten stability—namely, *inflation, deflation,* and *unemployment*.

Inflation **Inflation** is evident when the amount of money injected into an economic system outstrips the increase in actual output. When inflation occurs, people have more money to spend, but there will still be the same quantity of products available for them to buy. As they compete with one another to buy available products, prices go up. Before long, high prices will erase the increase in the amount of money injected into the economy. Purchasing power, therefore, declines. Figure 2.3 shows how inflation has varied over the last 30 years in Canada.

Inflation varies widely across countries. One dramatic example occurred in Zimbabwe in 2008, when inflation reached an astonishing annual rate above 40 million percent (most countries have rates between 2 and 15 percent). One Zimbabwean dollar from 2005 would have been worth one trillion Zimbabwean dollars in 2008. Many workers simply stopped going to their jobs because their pay was not enough to cover their bus fare.[20] The problem was finally solved in 2009 when the government began allowing people to pay their bills using other currencies, like the U.S. dollar or the South African rand.[21]

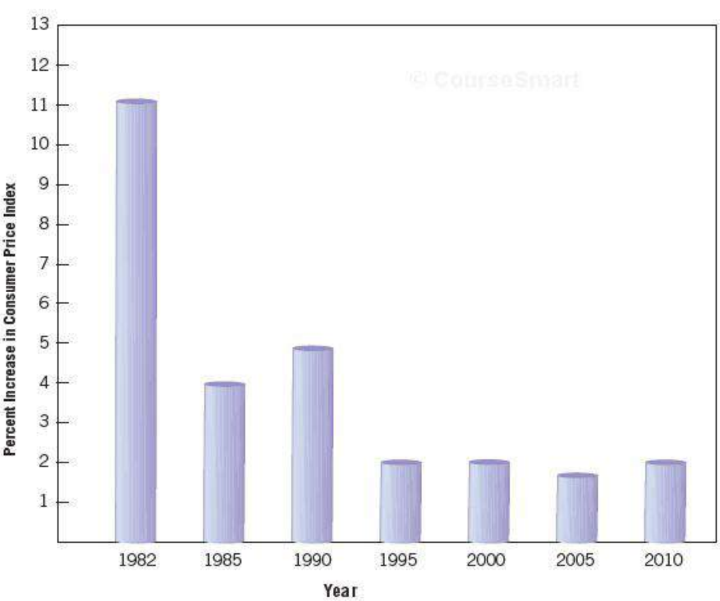


Figure 2.3
During the past fifteen years, the rate of price increases in Canada has been low and quite stable.

Measuring Inflation: The CPI The **consumer price index (CPI)** measures changes in the cost of a "basket" of goods and services that a typical family buys. What is included in the basket has changed over the years. For example, the first CPI in 1913 included items like coal, spirit vinegar, and fruit, while today the index includes bottom-freezer fridges, flat-screen TVs, energy-saving light bulbs, and laser eye surgery.[22] These changes in the CPI reflect changes that have occurred in the pattern of consumer purchases. For example, in 1961, about 53 percent of consumer spending went to necessities like food, housing, and clothing. By the turn of the century, only 40 percent of consumer spending went to necessities.[23]

STABILITY Condition in an economic system in which the amount of money available and the quantity of goods and services produced are growing at about the same rate.

INFLATION Occurrence of widespread price increases throughout an economic system.

CONSUMER PRICE INDEX (CPI) Measure of the prices of typical products purchased by consumers living in urban areas.

DEFLATION A period of generally falling prices.

UNEMPLOYMENT The level of joblessness among people actively seeking work in an economic system.

Deflation **Deflation** (falling prices) is evident when the amount of money injected into an economic system lags behind increases in actual output. Prices may fall because industrial productivity is increasing and cost savings are being passed on to consumers (this is good), or because consumers have high levels of debt and are therefore unwilling to buy very much (this is bad).

Unemployment In 2009, there were 7.7 million men and 6.9 million women (over age 25) working in Canada's labour force.[24] But there were many additional people who wanted a job but could not get one. **Unemployment** is the level of joblessness among people actively seeking work. There are various types of unemployment: *frictional unemployment* (people are out of work temporarily while looking for a new job); *seasonal unemployment* (people are out of work because of the seasonal nature of their jobs); *cyclical unemployment* (people are out of work because of a downturn in the business cycle); and *structural unemployment* (people are unemployed because they lack the skills

FISCAL POLICIES
Policies whereby governments collect and spend revenues.

MONETARY POLICIES
Policies whereby the government controls the size of the nation's money supply.

needed to perform available jobs). Unemployment rates have varied greatly over the years, as Figure 2.4 shows, with the rates for men generally being higher than the rates for women. In June 2010, the Canadian unemployment rate stood at 8.1 percent, which was higher than the 6 to 7 percent average range for the previous decade, before the recession, but was better than the rate in the Unites States, which stood at 9.7 percent and the depressing 20.1 percent rate found in Spain at the time.[25]

When unemployment is low there is a shortage of labour available for businesses. As businesses compete with one another for the available supply of labour, they raise the wages they are willing to pay. Then, because higher labour costs eat into profit margins, businesses raise the prices of their products. If prices get too high, consumers will respond by buying less. Businesses will then reduce their workforces because they don't need to produce as much. But this causes unemployment to go up and the cycle starts all over again.

During the depression of the 1930s, unemployment was very high, with nearly one-quarter of the population unable to find work. Lines of unemployed workers outside soup kitchens were an unfortunate reality during those difficult economic times.

Managing the Canadian Economy

The federal government manages the Canadian economic system through two sets of policies: fiscal and monetary. **Fiscal policies** involve the collection and spending of government revenues. For example, when the growth rate of the economy is decreasing, tax cuts will normally stimulate renewed economic growth. **Monetary policies** focus on controlling the size of the nation's money supply. Working primarily through the Bank of Canada (see Chapter 15), the government can influence the ability and willingness of banks throughout the country to lend money. The power of the Bank of Canada to make changes in the supply of money is the centrepiece of the Canadian government's monetary policy. The principle is fairly simple:

- Higher interest rates make money more expensive to borrow and thereby reduce spending by companies that produce goods and services and consumers who buy them. When the Bank of Canada restricts the money supply, we say that it is practising a *tight monetary policy*.

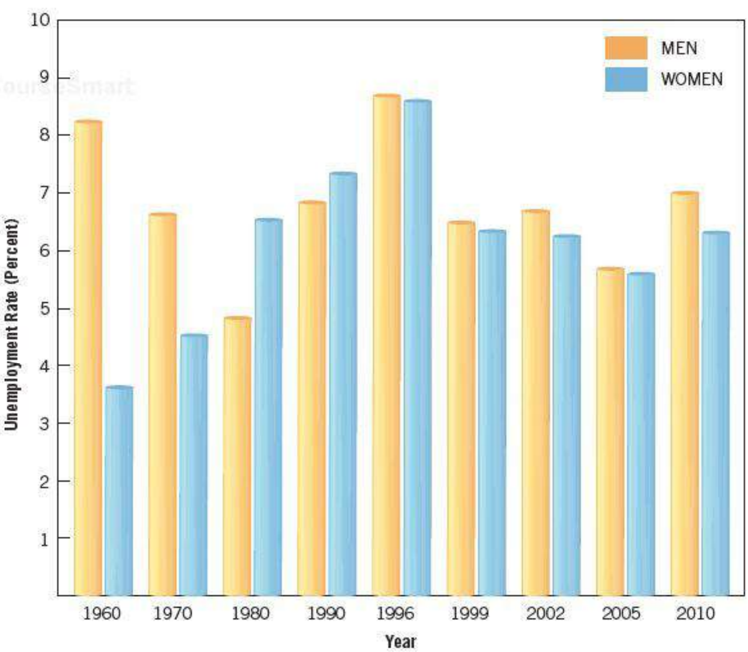


Figure 2.4
Historical unemployment rate. From 1970 to 1996, there was a steady upward trend in unemployment rates, but the rate began to decline in the late 1990s. The recession, which began in 2008, caused a clear increase in unemployment, as seen in the chart.

- Lower interest rates make money less expensive to borrow and thereby increase spending by both companies that produce goods and services and consumers who buy them. When the Bank of Canada loosens the money supply, we say that it is practising an *easy monetary policy*. When the financial crisis hit in the fall of 2008, the central banks around the world cut their interest rates in an attempt to stimulate their countries' economies.

LO-3 The Technological Environment

As applied to the environment of business, **technology** lgenerally includes all the ways by which firms create value for their constituents. Technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems that are used to perform business activities. Although technology is applied within organizations, the forms and availability of that technology come from the general environment. Boeing, for example, uses computer-assisted manufacturing and design techniques developed by external vendors to simulate the four miles of hydraulic tubing that run through its new 777 aircraft.

Research and Development (R&D)

Technological improvements and innovation in general are important contributors to the economic development of a country. The innovation process includes **research and development (R&D)**, which provides new ideas for products, services, and processes (see Chapter 13; the importance of R&D in the marketing of products). There are two types of R&D. **Basic (or pure) R&D** involves improving knowledge in an area without a primary focus on whether any discoveries that might occur are immediately marketable. For example, chemists in a laboratory might examine how certain chemical compounds behave. The knowledge gained from this activity might or might not result in a marketable product. **Applied R&D**, on the other hand, means focusing specifically on how a technological innovation can be put to use in the making of a product or service that can be sold in the marketplace. For example, H.J. Heinz developed a tomato that is sweeter than the variety it previously used to make its ketchup. This reduced the need for corn syrup, which had been rapidly increasing in price.[26]

R&D spending in Canada in 2009 totalled about $16.1 billion.[27] The Canadian private sector accounts for about 55 percent of R&D, the government 10 percent, and universities 34 percent.[28] In the private sector, just 100 businesses account for over half of all R&D money that is spent.[29] The largest expenditures on R&D in Canada are concentrated in industries like computer system design, information, communications equipment, and scientific research.[30]

Canada's level of R&D investment lags behind that of other countries; it typically spends less than 1 percent of GDP on R&D, while Japan, Germany, and the U.S., for example, spend from 1.5 to 2 percent of GDP. This lag exists partly because many Canadian businesses are subsidiaries of large U.S. companies that carry out their R&D in the United States. When we take into account that the GDP of these three countries is much larger than the GDP of Canada, it means that R&D spending in Canada (in absolute dollars) is a tiny fraction of what is spent by these nations.

The boxed insert entitled "The Hydrogen Fuel Cell" describes how complex and time-consuming research and development work can be.

TECHNOLOGY All the ways firms create value for their constituents.

RESEARCH AND DEVELOPMENT (R&D) Those activities that are necessary to provide new products, services, and proesses.

BASIC (OR PURE) R&D Improving knowledge in an area without a primary focus on whether any discoveries that might occur are immediately marketable.

APPLIED R&D Focusing specifically on how a technological innovation can be put to use in the making of a product or service that can be sold in the marketplace.

Product and Service Technologies

Product and service technologies are employed for creating products—both physical goods and services—for customers. Although many people associate technology with manufacturing, it is also a significant factor in the service sector. Just as an automobile is built as it follows a predetermined pathway along an assembly line, a hamburger at McDonald's is cooked, assembled, and wrapped as it moves along a predefined path. The rapid advancement of the internet into all areas of business is also a reflection of the technological environment. Indeed, new technologies continue to revolutionize nearly every aspect of business, ranging from the ways that customers and companies interact to where, when, and how employees perform their work.

Companies must constantly be on the lookout for technological breakthroughs that might make their products or services obsolete and thereby threaten their survival. Many of these breakthroughs do not come from direct competitors or even from the industry the company is part of. Technology is the basis of competition for some companies, especially when their goal is to be the technology leader in their industry. A company, for example, might focus its efforts on having the most technologically advanced products on the market. Intel

TECHNOLOGY TRANSFER
The process of getting a new technology out of the lab and into the marketplace.

exemplifies the challenge and the risks of adopting a strategic dependence on technological leadership. Before co-founding Intel with Bob Noyce in 1968, Gordon Moore made a prediction about microprocessors (the processing components of microcomputers) that eventually became known as Moore's Law: The number of transistors in a microprocessor would double every 18 months. In effect, this rate would entail a twofold increase in processing power every 18 months—a seemingly impossible pace. Intel, however, adopted Moore's Law as a performance requirement for each new generation of processor and has kept up this pace for over 40 years.[31]

Because of the rapid pace of new developments, keeping a leadership position based on technology is increasingly difficult. **Technology transfer** refers to the process of getting a new technology out of the lab and into the marketplace where it can generate profits for the company. Efficient technology transfer means an increased likelihood of business success. A related challenge is meeting the constant demand to decrease *cycle time*—the time from beginning to end that it takes a firm to accomplish some recurring activity or function. Since businesses are more competitive if they can decrease cycle times, many companies now focus on decreasing cycle times in areas ranging

THE GREENING OF BUSINESS

The Hydrogen Fuel Cell

The hydrogen fuel cell combines hydrogen (one of earth's most common elements) with oxygen to produce electricity. The electricity generated by the fuel cell can be used to power anything that runs on electricity, including cars, and the only exhaust is warm water. When Vancouver-based Ballard Power Systems announced in the 1990s that it was developing the hydrogen fuel cell, excitement was high because automakers had tried for years to develop a new engine to replace the internal combustion engine that has powered automobiles for over a century. DaimlerChrysler and Ford Motor Co. invested hundreds of millions of dollars to pursue the development of fuel cells. Ballard sold prototypes to several public transportation companies in the U.S. and Canada, but more than 15 years have now passed, and the hydrogen fuel cell is still not ready for the mass market.

What happened? Why is the fuel cell—which looks like a fantastic product—still not widely available? Consider the daunting list of problems facing the fuel cell:

- Hydrogen must first be extracted from substances that contain it (e.g., natural gas), but stripping the hydrogen from natural gas creates carbon dioxide, which is precisely what the standard internal combustion car engines emit.
- Safety is an issue (when the word "hydrogen" is mentioned, many people immediately think of the spectacular explosion and fire that destroyed the hydrogen-powered Hindenburg airship in 1937).
- If insufficient numbers of hydrogen-dispensing gas stations are built, consumer demand will never be high enough to encourage mass production of cars that are powered by fuel cells.
- Hybrid cars like the Toyota Prius and the Honda Civic have been very successful and are providing strong competition for the hydrogen fuel cell.

The fuel cell may be commercially viable in 20 or 30 years, but there are still many developmental problems to be overcome and progress is slow. In 2008, Honda began producing the FCX Clarity, a zero-emission, fuel cell–powered car, but mass market sales are not likely until 2018. The company says that the biggest impediments to sales are the high price of the car and the lack of availability of hydrogen fuelling stations.

Maybe the hydrogen fuel cell will eventually become popular. Keep in mind what critics said when internal combustion–powered automobiles were introduced early in the twentieth century: "They'll never become popular because there would have to be gas stations all over the place." Well, now we have gas stations all over the place.

Critical Thinking Questions

1. Review the section on new product development in Chapter 13. At what stage of the new product development process is the hydrogen fuel cell?
2. Consider the following statement: *"If the fuel cell had any value, it would have been fully developed by now and there would already be many cars on the road that are powered by the fuel cell."* Do you agree or disagree with the statement? Explain your reasoning.

from developing products to making deliveries and collecting credit payments. Twenty years ago, it took automakers about five years from the decision to launch a new product until it was available in dealer showrooms. Now most companies can complete the cycle in less than two years.

LO-4 The Political–Legal Environment

The **political–legal environment** reflects the relationship between business and government, including government regulation of business. The legal system defines what an organization can and can't do. Although Canada is a free market economy, there is still significant regulation of business activity, as we saw in Chapter 1. At times government policy can be tremendously advantageous to businesses. The home renovation tax credit, which expired in 2010, brought a 30 percent sales increase for Winnipeg-based Acrylon Plastics (maker of window frames) and had hardware retailers smiling from coast to coast.[32] On the other hand, Shoppers Drug Mart was very vocal about its opposition to a new Ontario government regulation that would see generic drugs priced at as low as 25 percent of the original brand name product's cost, down from 50 percent. This regulation would have a tremendous impact on pharmacy profits.[33]

Society's general view of business (pro or anti) is also important. During periods of anti-business sentiment, companies may find their competitive activities restricted.

Political stability is also an important consideration, especially for international firms. No business wants to set up shop in another country unless trade relationships with that country are relatively well defined and stable. Thus, Canadian firms are more likely to do business in England rather than in Haiti. For example, in 2010, mining companies were concerned about rumours that members of the South African ruling government were considering nationalization (government takeover of resources, forcing private companies to sell at a price deemed fair by the government) of up to 60 percent of the country's mining sector. This was a dangerous prospect for Vancouver-based Great Basin Gold Ltd., which was developing a $230 million gold mining operation at the time.[34]

Relations between sovereign governments can also affect business activity. When Canada refused to send troops to support the U.S. invasion of Iraq, relations between the two nations were very cool for a time. Similar issues also pertain to assessments of local and provincial governments. A new mayor or provincial leader can affect many organizations, especially small firms that do business in a single location and are susceptible to zoning restrictions, property and school taxes, and the like.

Another aspect of the political–legal environment is described in the boxed insert entitled "Nova Scotia's Golden Nectar."

POLITICAL–LEGAL ENVIRONMENT Conditions reflecting the relationship between business and government, usually in the form of government regulation.

SOCIO-CULTURAL ENVIRONMENT Conditions including the customs, values, attitudes, and demographic characteristics of the society in which an organization functions.

LO-5 The Socio-Cultural Environment

The **socio-cultural environment** includes the customs, values, attitudes, and demographic characteristics of the society in which a company operates. The socio-cultural environment influences the customer preferences for goods and services, as well as the standards of business conduct that are seen as acceptable.

Customer Preferences and Tastes

Customer preferences and tastes vary both across and within national boundaries. In some countries, consumers are willing and able to pay premium prices for designer clothes with labels such as Armani. But the same clothes have virtually no market in other countries. Product usage also varies between nations. In China, bicycles are primarily seen as a mode of transportation, but in Canada, they are marketed primarily for recreational purposes.

Consumer preferences can also vary widely within the same country. Customs and product preferences in Quebec, for example, differ from those in other parts of Canada. In the United States, pre-packaged chilli is more popular in the southwest than in the northeast. McDonald's is just one company that is affected by socio-cultural factors. In response to concerns about nutrition and health, McDonald's has added salads to its menus and experimented with other low-fat foods. It was the first fast-food chain to provide customers with information about the ingredients in its products, and it attracted media attention when it announced that it would reduce the fat content in its popular French fries.

Consumer preferences and tastes also change over time. Preferences for colour, style, taste, and so forth change from season to season. In some years, brightly coloured clothes sell best, while in other years, people want more subdued colours. Some of these changes are driven by consumers, and some are driven by companies trying to

ENTREPRENEURSHIP AND NEW VENTURES

Nova Scotia's Golden Nectar: Glen Breton Rare

Cape Breton, Nova Scotia–based Glenora Distilleries battled fiercely to keep its Glen Breton Rare Single Malt Whisky on store shelves. It's not like the product lacked demand; Glenora distils the only single-malt whisky produced in Canada. The court battle dragged on from 2000 until mid-2009. The Scotch Whisky Association, a group representing over 50 whisky distillers in Scotland, claimed the company's use of "Glen" in its brand is confusing consumers and leading them to believe that the product is distilled in Scotland.

Lauchie MacLean, Glenora's president, strongly disagreed. He argued the name referred to Glenora Distillery's home community: Glenville, Cape Breton. Fortunately, a Canadian Federal Court of Appeal's ruling, in January 2009, allowed the company to continue to use the name. This ruling was supported, in June 2009, when the Supreme Court of Canada refused to hear the case and put an end to the legal battle. This move cleared the way for Glen Breton to get a legal trademark in Canada.

The latest clash hasn't been the only form of legal restriction imposed on Glenora Distillery and other whisky producers around the globe. Distillers based in Scotland have set out to protect the use of the label "scotch." One such move was an agreement signed by Canada and the European Union in 2003 that prevented Canadian whisky distillers from using the word "scotch" in their label. This term is reserved for Scotland-based distillers only. Glenora has always complied with this ruling but wasn't ready to lie down when the association's latest assault threatened its "Glen Breton" brand. But now, the future looks bright for a company that has had its fair share of challenges. Not only has it secured its most valuable possession, its brand name, it is also excited about the growing whisky market.

Because of increased demand in Europe and Asia, some single-malt whisky distillers have found their products in short supply. As a result, many distillers are pulling out of some markets and entering others. It's simple economics according to MacLean: "They [distillers] have an asset, and they're looking at selling that asset for the most money that they can get out of it." Glenora is a relatively small producer, but the company hopes to increase production at a later date to better match demand. Currently, Glenora is not "heavily into the Asian market," but expect that to change over the next few years.

Glenora's successes have partly been due to its entrepreneurial flexibility. The company experienced serious cash flow problems not long after its launch in 1991 because distilling doesn't happen overnight—it can take 10 to 12 years before a distillery will see revenues. However, some innovative approaches, which involved selling whisky futures and adding rum bottling and complementary tourism operations to the business, brought the company through the tough times. The business environment hasn't always been kind to Glenora, but in true entrepreneurial fashion, it has persevered. *Sláinte!*

Critical Thinking Question

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

convince consumers to adopt new styles. These and many other related issues regarding businesses and their customers are explored more fully in Part IV of this book, which deals with the marketing of goods and services.

Socio-cultural factors also influence the way workers in a society feel about their jobs and organizations. In some cultures, work carries meaningful social significance, with certain employers and job titles being highly desired by workers. But in other cultures, because work is simply a means to an end, people are concerned only with pay and job security. McDonald's has occasionally struggled with its operations in the Middle East because many people there are not interested in working in food-service operations.

Ethical Compliance and Responsible Business Behaviour

An especially critical element of the socio-cultural environment is the practice of ethical conduct and social responsibility. We cover these areas in detail in Chapter 3, but they are sufficiently important that we describe a couple of points briefly here: the reporting of a company's financial position and a company's social responsibility toward citizens.

Keeping up with today's increasingly fast-paced business activities is putting a strain on the accounting profession's traditional methods for auditing, financial reporting, and time-honoured standards for professional ethics. The stakeholders of business firms—employees, stockholders, consumers, labour unions, creditors, and the government—are entitled to a fair accounting so they can make enlightened personal and business decisions, but they often get a blurred picture of a firm's competitive health. Nortel went from being the pride and joy of Canada to a historical warning. Nortel suffered at the turn of the century because the internet bubble burst. This was an external factor that had an impact on all technology companies but was not why Nortel failed; a major reason for the bankruptcy was the failure to get its financial house in order. The company made accounting restatement after restatement of its financials throughout the last decade of its existence. Restatement is a clever way of saying that the figures that the company presented to its stakeholders were inaccurate. When that happens one time it can be seen as an error. When it is repeated over time it is a clear attempt to deceive the market.

In 2010, British Petroleum (BP) was in the news for all the wrong reasons and faced the consequences of the massive Gulf of Mexico oil spill. For years, BP and other oil companies said that high-tech offshore drilling was extremely safe. But in 2010, when disaster struck, it became clear that the deep-sea environment was difficult and that BP did not have an adequate solution for the problem. For months the oil spewed into the Gulf, devastating coastlines, endangering wildlife, and battering the local fishing and tourism businesses. This failure had consequences and the various stakeholders were lining up to make BP pay. Within a few days, a Facebook page promoting a BP boycott had 360 000 supporters. Advocacy groups like Public Citizen held rallies against BP. The U.S. government was publicly pushing the company for a quick solution while demanding BP halt a $10.5 billion dividend payment to shareholders. The U.S. government was also planning a legal response to make BP pay for its mistake in the court system. The future of BP was at stake (something that was unimaginable before the crisis).[35]

The Business Environment

Business today is faster paced, more complex, and more demanding than ever before. As businesses aggressively try to differentiate themselves, there has been a trend toward higher-quality products, planned obsolescence, and product life cycles measured in weeks or months rather than years. This, in turn, has created customer expectations for instant gratification. Ultimate consumers and business customers want high-quality goods and services—often customized—with lower prices and immediate delivery. Sales offices, service providers, and production facilities are shifting geographically as new markets and resources emerge in other countries. Employees want flexible working hours and opportunities to work at home. Stockholder expectations also add pressure for productivity increases, growth in market share, and larger profits. At the same time, however, a more vocal public demands more honesty, fair competition, and respect for the environment.

A C-Suite survey found that the three most important issues facing Canadian businesses are (1) the value of the Canadian dollar, (2) a skilled labour shortage, and (3) the environment. These three issues are all important elements of the business environment.[36]

The Industry Environment

Each business firm operates in a specific industry, and each industry has different characteristics. The intensity of the competition in an industry has a big influence on how a company operates. To be effective, managers must understand the competitive situation, and then develop a competitive strategy to exploit opportunities in the industry.

One of the most popular tools to analyze competitive situations in an industry is Michael Porter's five forces model.[37] The model (see Figure 2.5) helps managers analyze five important sources of competitive pressure and then decide what their competitive strategy should be. We briefly discuss each of the elements of the model in the following paragraphs.

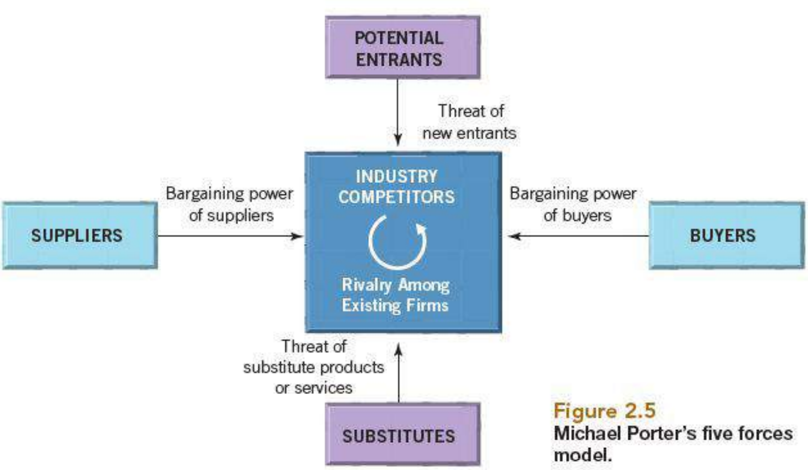


Figure 2.5
Michael Porter's five forces model.

CORE COMPETENCIES Skills and resources with which an organization competes best and creates the most value for owners.

OUTSOURCING Strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or services.

VIRAL MARKETING Strategy of using the internet and word-of-mouth marketing to spread product information.

Rivalry Among Existing Competitors The amount of rivalry among companies varies across industries. Rivalry can be seen in activities like intense price competition, elaborate advertising campaigns, and an increased emphasis on customer service. For many years, the rivalry among chartered accountants, certified general accountants, and certified management accountants in Canada was low-key, but it has recently become much more intense. Firms are responding by cutting costs, making pricing deals with clients, and trying to find ways to differentiate themselves from their competitors.

Threat of Potential Entrants When new competitors enter an industry, they may cause big changes. If it is easy for new competitors to enter a market, competition will likely be intense and the industry will not be that attractive. Some industries (e.g., automobile manufacturing) are very capital-intensive and are therefore difficult to enter, but others (e.g., home cleaning or lawn care services) are relatively easy to enter.

Suppliers The amount of bargaining power suppliers have in relation to buyers helps determine how competitive an industry is. When there are only a few suppliers in an industry, they tend to have great bargaining power. The power of suppliers is influenced by the number of substitute products that are available (i.e., products that perform the same or similar functions). When there are few substitute products, suppliers obviously have more power.

Buyers When there are only a few buyers and many suppliers, the buyers have a great deal of bargaining power. Retail powerhouse Walmart, for example, is often cited as a buyer that puts tremendous pressure on its suppliers to reduce their prices. Walmart can do this because it buys so much from these suppliers.

Substitutes If there are many substitute products available, the industry is more competitive. For example, various synthetic fibres can be used as substitutes for cotton. Managers use Porter's model to help them decide the level of competitive intensity in an industry. A good example is the impact of the internet on airline tickets and car rentals. By making it easier for consumers to compare prices, the internet has increased the competitive intensity of these two industries (and many others, for that matter). In effect, the internet has increased the bargaining power of ticket buyers.

LO-6 Emerging Challenges and Opportunities in the Business Environment

The most successful firms are dealing with challenges and opportunities in today's business environment by focusing on their **core competencies**—the skills and resources with which they compete best and create the most value for owners. They outsource non-core business processes and pay suppliers and distributors to perform them, thereby increasing their reliance on suppliers. These new business models call for unprecedented coordination—not only among internal activities but also among customers, suppliers, and strategic partners—and they often involve globally dispersed processes and supply chains.

In this section, we discuss some of the most popular steps that companies have taken to respond to challenges and opportunities in the business environment. These include *outsourcing, social media and viral marketing,* and *business process management*.

Outsourcing **Outsourcing** is the strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or services. For example, the cafeteria in a museum may be important to employees and customers, but the museum's primary focus is on exhibits that will interest the general public, not on food-service operations. That's why museums usually outsource cafeteria operations to food-service management companies. The result is more attention to museum exhibits and better food service for customers. Firms today outsource numerous activities, including payroll, employee training, and research and development.

Social Media and Viral Marketing Social media sites such as Facebook are now an important part of everyday life for consumers (especially the youth market). Companies are addressing this new reality by providing content and creating links for consumers. Most organizations are being careful about their online presence because they don't want it to be seen as an imposition but rather a natural extension to their real-world relationship with clients. As we discuss throughout this book, in the E-Business and Social Media Solutions boxes, some companies are making strong inroads as this new model evolves and companies learn to deal with an empowered consumer base.

Viral marketing predates the social media craze and first gained prominence through basic email transfer; it describes word of mouth that spreads information like a virus from customer to customer, and relies on the internet to replace face-to-face communications. Messages about new cars, sports events, and numerous other goods and services travel on the internet among potential customers, who pass the information on. Using various formats—games, contests, chat rooms, and bulletin boards—marketers encourage potential customers to try out products and tell other people about them.[38] This approach has even more potential today with the likes of Twitter providing even quicker means to move messages.

Viral marketing works because people increasingly rely on the internet for information that they used to get from other media such as radio and newspapers, and because the customer becomes a participant in the process of spreading the word by forwarding information to other internet users. Take a look at the E-Business and Social Media Solutions box entitled "Corus Entertainment Looking for Listeners and Revenues in New Places."

Business Process Management A **process** is any activity that adds value to some input, transforming it into an output for a customer (whether external or internal).[39] For example, human resource departments perform interviewing and hiring processes; payroll departments perform the employee-payment process; the purchasing department performs the process of ordering materials; accounting performs the financial reporting process; and marketing performs the process of taking orders from customers.

Business process management means moving away from organizing around departments and moving toward organizing around process-oriented team structures that cut across old departmental boundaries. Often, companies begin by asking, "What must we do well to stay in business and win new orders?" Next, they identify the major processes that must be performed well to achieve these goals. Then they organize resources and skills around those essential processes. By organizing according to processes rather than functional departments, decision making is faster and more customer-oriented, materials and operations are coordinated, and products get to customers more rapidly.[40]

PROCESS Any activity that adds value to some input, transforming it into an output for a customer (whether external or internal).

BUSINESS PROCESS MANAGEMENT Approach by which firms move away from department-oriented organization and toward process-oriented team structures that cut across old departmental boundaries.

ACQUISITION The purchase of a company by another, larger firm, which absorbs the smaller company into its operations.

MERGER The union of two companies to form a single new business.

LO-7 Redrawing Corporate Boundaries

Successful companies are responding to challenges in the external environment by redrawing traditional organizational boundaries, and by joining together with other companies to develop new goods and services. Several trends have become evident in recent years: *acquisitions and mergers, divestitures and spinoffs, employee-owned corporations, strategic alliances,* and *subsidiary/parent corporations*.

Much concern has been expressed by government officials and labour unions that the outsourcing of jobs will hurt the Canadian economy. Here, women work in one of many call centres in New Delhi, India, work that has been outsourced by Canadian and U.S. companies.

Acquisitions and Mergers

In an **acquisition**, one firm simply buys another firm. For example, Kraft Foods Inc. recently bought British candy giant Cadbury for US$19 billion.[41] The transaction is similar to buying a car that becomes your property. In contrast, a **merger**

Corus Entertainment Looking for Listeners and Revenues in New Places

Do you remember when cameras were used to create photos, phones were used to make phone calls, and TVs were used to watch TV programs? Today things are different. You can watch TV on your phone, laptop, or even the LCD on your wall. Your smart phone or regular cell is a great tool for photos and your camera has an ever-increasing level of mega-pixels. As for music, it can come from your iPod, smart phone, a satellite station, or streamed from a website from your favourite station in Surrey, Saskatoon, St. John's, or even South Africa. Options are limitless. Faced with this new reality, the companies that own your favourite stations are looking for new ways to attract listeners like you.

Corus Entertainment is extending its relationship with listeners and finding ways to profit from it as well. In the early days of the internet, stations were simply excited about the chance to share music and shows with anyone who would listen online. However, this also meant that their listeners could migrate to stations from anywhere—a scary prospect. Corus Entertainment has come a long way in the last decade. Visiting one of its radio websites (e.g., Vancouver's 99.3 The Fox, Toronto's Edge 102.1, Calgary Country 105, Edmonton's 92.5 Joe FM, Winnipeg's Power 97, and Hamilton's Y108) makes it clear that even if the call letters are the same, these stations are no longer simply your father's radio station (unless Dad is especially media savvy). There are links to Facebook, Flickr, MySpace, Twitter, Viigo (for BlackBerry), YouTube, and more. There are blogs and podcasts and the tools to connect, join contests, and create virtual bonds. Corus also takes it a step further; it was the first to offer an iPhone streaming app and the first to form direct links with iTunes. You can purchase, via a special version of the Apple iTunes music store linked to your station, the song that you're currently listening to. In the process, Corus stands to add a few pennies to its bottom line.

Here is the new math that Corus and its advertising partners are studying. In 2009, Corus achieved over 7 million online listening hours per month; one out of every 20 listeners was accessing their stations through mobile devices or online, and this figure was expected to grow rapidly. However, with all of these positive signs, Corus sold its 12 Quebec-based stations to Cogeco Cable Inc. for $81 million in 2010. Corus stated that it wanted to focus on its other key markets. Was this a sign that all was not well or was Corus simply focusing on selected stations and reinvesting its new business model in key spots? This was not clear at the time. In the e-business age one thing is certain: companies must be ready to adjust and evolve in order to be successful.

An example of a Corus Entertainment radio station web site (Vancouver's 99.3 The Fox).

Critical Thinking Question

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

is a consolidation of two firms, and the arrangement is more collaborative. In the first quarter of 2010, there were 246 mergers and acquisitions in Canada, with a value of $19.7 billion, but this figure was much lower than the previous quarter, which had 285 deals worth $34.4 billion.[42]

When the companies are in the same industry, as when Molson Inc. merged with Adolph Coors Co., it is called a **horizontal merger**. When one of the companies in the merger is a supplier or customer to the other, it is called a **vertical merger**. When the companies are in unrelated businesses, it is called a **conglomerate merger**. A merger or acquisition can take place in one of several ways. In a **friendly takeover**, the acquired company welcomes the acquisition, perhaps because it needs cash or sees other benefits in joining the acquiring firm. But in a **hostile takeover**, the acquiring company buys enough of the other company's stock to take control even though the other company is opposed to the takeover. Montreal-based Couche-Tard has plenty of experience in the merger and takeover game (in the past 15 years it has acquired Mac's, Dairy Mart, Circle K, and Winks); it is one of the biggest convenience store operators in North America with over 5800 stores. In 2010, it made a US$1.9 billion hostile takeover bid for Iowa-based Casey's after failing to come to a friendly agreement for the 1500-store chain.[43]

A **poison pill** is a defence that management adopts to make a firm less attractive to an actual or potential hostile suitor in a takeover attempt. The objective is to make the "pill" so distasteful that a potential acquirer will not want to swallow it. BCE Inc., for example, adopted a poison pill that allowed its shareholders to buy BCE stock at a 50 percent discount if another company announced its intention to acquire 20 percent or more of BCE's shares.[44]

Divestitures and Spinoffs

A **divestiture** occurs when a company decides to sell part of its existing business operations to another corporation. For example, Unilever—the maker of Close-Up toothpaste, Dove soap, Vaseline lotion, and Q-tips—at one time owned several specialty chemical businesses that made ingredients for its consumer products. The company decided that it had to focus more on the consumer products themselves, so it sold the chemical businesses to ICI, a European chemical company.

In other cases, a company might set up one or more corporate units as new, independent businesses because a business unit might be more valuable as a separate company. This is known as a **spinoff**. For example, PepsiCo spun off Pizza Hut, KFC, and Taco Bell into a new, separate corporation now known as Yum! Brands Inc., and Canadian Pacific spun off Canadian Pacific Railway, CP Ships, Pan Canadian Petroleum, and Fording Coal.

Employee-Owned Corporations

Corporations are sometimes owned by the employees who work for them. The current pattern is for this ownership to take the form of **employee stock ownership plans**, or ESOPs. A corporation might decide to set up an ESOP to increase employee motivation or to fight a hostile takeover attempt. The company first secures a loan, which it then uses to buy shares of its stock on the open market. Some of the future profits made by the corporation are used to pay off the loan. The stock, meanwhile, is controlled by a bank or other trustee. Employees gradually gain ownership of the stock, usually on the basis of seniority. But even though they might not have physical possession of the stock for a while, they control its voting rights immediately.

A survey of 471 Canadian and U.S. companies conducted by Western Compensation & Benefits Consultants of Vancouver found that three-quarters of the companies that have adopted ESOPs have experienced improvement in both sales and profits. Charlie Spiring, the CEO of Wellington West Holdings Inc., says that one of the fundamental principles of his business is employee ownership. People really have to be entrepreneurs to work well in the company.[45]

HORIZONTAL MERGER A merger of two firms that have previously been direct competitors in the same industry.

VERTICAL MERGER A merger of two firms that have previously had a buyer–seller relationship.

CONGLOMERATE MERGER A merger of two firms in completely unrelated businesses.

FRIENDLY TAKEOVER An acquisition in which the management of the acquired company welcomes the firm's buyout by another company.

HOSTILE TAKEOVER An acquisition in which the management of the acquired company fights the firm's buyout by another company.

POISON PILL A defence that management adopts to make a firm less attractive to an actual or potential hostile suitor in a takeover attempt.

DIVESTITURE Occurs when a company sells part of its existing business operations to another company.

SPINOFF Strategy of setting up one or more corporate units as new, independent corporations.

EMPLOYEE STOCK OWNERSHIP PLANS An arrangement whereby a corporation buys its own stock with loaned funds and holds it in trust for its employees. Employees "earn" the stock based on some condition such as seniority. Employees control the stock's voting rights immediately, even though they may not take physical possession of the stock until specified conditions are met.

STRATEGIC ALLIANCE An enterprise in which two or more persons or companies temporarily join forces to undertake a particular project.

SUBSIDIARY CORPORATION One that is owned by another corporation.

PARENT CORPORATION A corporation that owns a subsidiary.

Strategic Alliances

A **strategic alliance**, or joint venture, involves two or more enterprises cooperating in the research, development, manufacture, or marketing of a product. For example, GM and Suzuki formed a strategic alliance at the Ingersoll, Ontario, plant where the Equinox and Grand Vitaras are made. Companies form strategic alliances for two main reasons: (1) to help spread the risk of a project, and (2) to get something of value (like technological expertise) from their strategic partner.

Subsidiary and Parent Corporations

A **subsidiary corporation** is one that is owned by another corporation. The corporation that owns the subsidiary is called the **parent corporation.** For example, the Hudson's Bay Company (HBC) is the parent corporation of Zellers and Home Outfitters.

Summary of Learning Objectives

1. **Explain the concepts of *organizational boundaries* and *multiple organizational environments*.** All businesses operate within a larger *external environment* consisting of everything outside an organization's boundaries that might affect it. An *organizational boundary* is that which separates the organization from its environment. Organizations have multiple environments: economic conditions, technology, political–legal considerations, social issues, the global environment, issues of ethical and social responsibility, the business environment itself, and numerous other emerging challenges and opportunities.
2. **Explain the importance of the *economic environment* to business and identify the factors used to evaluate the performance of an economic system.** The *economic environment* is the economic system in which business firms operate. The health of this environment affects business firms. The key goals of the Canadian system are economic growth, economic stability, and full employment. *Gross domestic product (GDP)* is the total value of all goods and services produced within a given period by a national economy domestically. The government manages the economy through *fiscal* and *monetary policies*.
3. **Describe the *technological environment* and its role in business.** *Technology* refers to all the ways firms create value for their constituents, including human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems. There are two general categories of business-related technologies: *product and service technologies* and *business process technologies*.
4. **Describe the *political–legal environment* and its role in business.** The *political–legal environment*

reflects the relationship between business and government. The legal system defines what an organization can and can't do. Various government agencies regulate important areas such as advertising practices, safety and health considerations, and acceptable standards of business conduct. Pro- or anti-business sentiment in government can further influence business activity.

5. **Describe the *socio-cultural environment* and its role in business.** The *socio-cultural environment* includes the customs, values, and demographic characteristics of society. Socio-cultural processes determine the goods and services as well as the standards of business conduct that a society values and accepts. Appropriate standards of conduct also vary across cultures. The shape of the market, the ethics of political influence, and the attitudes of its workforce are only a few of the many ways in which culture can affect an organization.

6. **Identify emerging challenges and opportunities in the *business environment*.** Successful companies are focusing on their core competencies. The innovative ways in which companies respond to emerging challenges and opportunities include *outsourcing*, *social media* and *viral marketing*, and *business process management*.

7. **Understand recent trends in the *redrawing of corporate boundaries*.** An *acquisition* occurs when one firm buys another. A *merger* occurs when two firms combine to create a new company. A *divestiture* occurs when a corporation sells a part of its existing business operations or sets it up as a new and independent corporation. When a firm sells part of itself to raise capital, the strategy is known as a *spin-off*. The *ESOP plan* allows employees to own a significant share of the corporation through trusts established on their behalf. In a *strategic alliance*, two or more organizations collaborate on a project for mutual gain.

Questions and Exercises

Questions for Analysis

1. It has been argued that inflation is both good and bad. Explain. Are government efforts to control inflation well-advised? Explain.
2. What are the benefits and risks of outsourcing? What, if anything, should be done about the problem of Canadian companies outsourcing jobs to foreign countries? Defend your answer.
3. Why is it important for managers to understand the environment in which their businesses operate?
4. Explain how current economic indicators such as inflation and unemployment affect you personally. Explain how they affect managers.
5. At first glance, it might seem as though the goals of economic growth and stability are inconsistent with one another. How can this apparent inconsistency be reconciled?
6. What is the current climate in Canada regarding the regulation of business? How might it affect you if you were a manager today?

Application Exercises

1. Select two businesses you are familiar with. Identify the major elements of their external environments that are most likely to affect them in important and meaningful ways.
2. Assume that you are the owner of an internet pharmacy that sells prescription drugs to U.S. citizens. Analyze the factors in the external environment (economic, technological, political–legal, and socio-cultural) that might facilitate your company's activities. Analyze the factors in the external environment that might threaten your company's activities.
3. Select a technology product, such as Amazon's Kindle e-reader, and research how the various environments of business (economic, technological, socio-cultural, global, political–legal, and general business) are currently impacting the sales possibilities of the product or service.
4. Interview two business owners or managers. Ask them to answer the following questions: (a) What business functions, if any, do they outsource? (b) Are they focusing more attention on business process management now than in the past? (c) How have internet applications and the growth of social media changed the way they conduct business?

TEAM EXERCISES

Building Your Business Skills

The Letdown from Environmental Upheaval

Goal

To encourage students to understand how local events can affect other businesses.

Situation

The collapse of Enron affected literally hundreds of other businesses. While attention has been directed primarily at the demise of Arthur Andersen, many other businesses suffered as well. For example, Enron's headquarters were located in a large office building on the edge of Houston's downtown business district. Because of both Enron's rapid growth and the prosperity of its employees, numerous other service providers had set up shop nearby—a shoeshine stand, a coffee shop, a dry cleaner, and two restaurants. When Enron collapsed, the demand for services provided by these small businesses dropped sharply.

Larger businesses were also caught up in the ripple effect. Enron, for example, had bought the rights to name the new home of Houston's baseball team, the Astros, Enron Field. The Astros were forced to remove all Enron signage and seek a new sponsor. Continental Airlines dominates the air traffic market out of Houston, and Enron was one of Continental's largest corporate clients; the end of business travel by Enron managers cost the airline considerable revenue.

Method

Divide into groups of four or five students; each group should begin by doing the following:

Step 1 Identify five kinds of small businesses likely to have been affected by Enron's collapse. You can include some of those identified above, but identify at least two others.

Step 2 Identify five kinds of large businesses likely to have been affected by Enron's collapse. Again, you can use some of those identified above, but identify at least two others.

Step 3 As a group, develop answers to each of the following:

1. For each company that you identify, both small and large, describe the specific effects of the Enron collapse on its business.
2. Describe the most logical organizational response of each company to these effects.
3. What kinds of plans, if any, should each organization develop in the event of similar future events?
4. Identify businesses that might have benefited economically from the collapse of Enron.

Alternative Assignment

Select a different high-profile environmental upheaval, such as the economic crisis that nearly caused the collapse of the major North American automakers. Then proceed with Steps 1–3 above.

Follow-Up Questions

1. What does this exercise demonstrate about the pitfalls of relying too heavily on one business?
2. Could any of these businesses have been better prepared for the Enron collapse?
3. Managers must be on the alert for environmental changes that might negatively affect their business. Is it possible for a manager to spend too much time trying to anticipate future events? Why or why not?

Exercising Your Ethics

Finding the Balance

The Situation

Managers often find it necessary to find the right balance among the interests of different stakeholders. For instance, paying employees the lowest possible wages can enhance profits, but paying a living wage might better serve the interests of workers. As more businesses outsource production to other countries, these trade-offs become more complicated.

The Dilemma

The Canadian Delta Company currently uses three suppliers in Southeast Asia for most of its outsourced production. Due to increased demand for its products, it needs to double the amount of business it currently subcontracts to one of these suppliers. (For purposes of this exercise, assume that the company must award the new supplier contract to a single firm, and that it must be one of these three. You can also assume that the quality provided is about the same for all three companies.)

Subcontractor A provides a plain but clean work environment for its workers. Even though the local weather conditions are usually hot and humid, the plant is not air-conditioned. Canadian Delta safety experts have verified that the conditions are not dangerous but are definitely uncomfortable. The firm pays its workers the same prevailing wage rate that is paid by its local competitors. While it has never had a legal issue with its workforce, Subcontractor A does push its employees to meet production quotas and it has a very tough disciplinary policy regarding tardiness. An employee who is late gets probation; a second infraction within three months results in termination. This subcontractor provides production to Canadian Delta at a level such that it can attach a 25 percent mark-up.

Subcontractor B also provides a plain work environment. It pays its workers about 5 percent above local wage levels and hence is an attractive employer. Because of its higher pay, this firm is actually quite ruthless in some of its policies. For instance, any employee who reports to work more than 15 minutes late without a medical excuse is automatically terminated. This supplier's costs are such that Delta Company can achieve a 20 percent mark-up.

Subcontractor C runs a much nicer factory than either A or B, and the plant is air-conditioned. It pays its workers about 10 percent above local wage levels. The company also operates an on-site school for the children of its employees, and provides additional training for its workers so they can improve their skills. Due to its higher costs, Canadian Delta's mark-up on this firm's products is only around 15 percent.

Team Activity

Assemble a group of four students and assign each group member to one of the following roles:

- Canadian Delta executive
- Canadian Delta employee
- Canadian Delta customer
- Canadian Delta investor

Action Steps

1. Before discussing the situation with your group, and from the perspective of your assigned role, decide which firm should get the additional business. Which firm is your second choice? Write down the reasons for your position.
2. Before discussing the situation with your group, and from the perspective of your assigned role, identify the underlying ethical issues in this situation. Write down the issues.
3. Gather your group together and reveal, in turn, each member's comments on their choices. Next, reveal the ethical issues listed by each member.
4. Appoint someone to record main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreement?
5. From an ethical standpoint, what does your group conclude is the most appropriate choice for the company in this situation? Why?

BUSINESS CASE 2

Inflation, Deflation, and the Validity of the CPI

Between 2008 and 2010, there was great fear and confusion in financial markets. The stock market saw a major decline and a major recovery and the roller coaster ride seemed far from over. It wasn't just because of the credit crisis, the housing crisis, the sovereign debt crisis, and the worldwide recession. There was also uncertainty about whether *inflation* or *deflation* was going to add to the problems that already existed. On one hand, it seemed logical to predict that inflation was going to get worse because central governments around the world cut interest rates and were injecting billions of dollars into their financial systems to get their economies moving again. On the other hand, the recession became so bad that the demand for goods and services was declining, commodity prices (including oil) were falling fast, banks were not loaning money (because they feared that borrowers wouldn't be able to repay their loans), consumers were reluctant to spend money, and everyone was hoarding cash. All of those factors suggested that deflation was going to occur.

To see how this complicated situation developed, we have to look back. In the first half of 2008, prices increased for many different products and services, including food, metals, energy, air transportation, gasoline, cable services, and mortgages. The Bank of Canada became concerned that inflation was becoming a real threat. The weakening of the Canadian dollar against the U.S. dollar also increased the threat since imported goods would be more expensive for Canadians. The International Monetary Fund (IMF) expressed concern that the strong demand for food and other resources in rapidly growing countries like India and China was going to cause increased inflation elsewhere in the world. The IMF's deputy managing director noted that there were about 50 countries in the world with inflation rates *above* 10 percent, mostly developing nations.

The interconnectedness of the global economy was also a problem. The U.S. Federal Reserve cut interest rates in an attempt to get the U.S. economy moving, but that caused the value of the U.S. dollar to decline relative to other currencies (at least for a while). That, in turn, meant that U.S. consumers would have to pay more for imported products. The rate cut also created problems for Middle Eastern and Asian countries that had pegged their dollar to the U.S. dollar in an attempt to stabilize their economies. When the United States reduced interest rates, those countries really had to follow suit; if they

didn't, people would move more money into their country (because they could earn a higher rate of return than they could in the United States). That, in turn, would create upward pressure on the currency of those Middle Eastern and Asian countries. It would also cause increased inflation because when interest rates decline, it is easier for people to borrow money.

All of these factors suggested that inflation was going to be a problem. But economic circumstances can change very quickly. Just a few months after the Bank of Canada expressed concerns about inflation, it decided to *cut* interest rates, even though doing so typically increases the chance of inflation. The Bank of Canada did this because commodity prices had suddenly declined and a worldwide recession had started. In spite of the rate cut, prices soon started dropping for meat, automobiles, computers, fresh fruit, furniture, appliances, tools, hardware, and a wide range of commodities, including oil. In China, overproduction of everything from laptop computers to building materials raised fears that many products would soon be dumped on world markets at cut-rate prices. That increased the chance of deflation (negative inflation). Support for deflation fears could be found in the fact that the rate of inflation in the U.S. economy between March 2008 and March 2009 was –0.1 percent. That was the first year of negative inflation since 1955.

Fears about deflation were not without foundation. Japan experienced deflation for 15 years after its housing bubble burst in the early 1990s. Then, just when it looked like Japan would escape from that problem, the U.S. Federal Reserve cut interest rates to almost 0 percent to get the U.S. economy moving. Japan's central bank followed suit; it didn't want the yen to rise in value because that would depress Japan's exports. But in 2010, matters were further complicated when the Bank of Canada announced it was raising rates and signalling that future rate hikes may be significant in the near term (partially because of fears of a potential housing bubble).

It is difficult to predict whether inflation or deflation is more likely partly because both situations are influenced by self-fulfilling prophecies. For example, if people think inflation is going to be a problem, they are motivated to buy things now in order to avoid paying the higher prices that they assume are soon to come. But buying things now creates more demand, and that causes prices to rise. Conversely, if people think deflation is going to occur, they are motivated to delay purchases to the time when the price will be lower. But putting off purchases lowers demand, and that causes prices to fall.

There is yet another angle to consider in this debate. According to statistician Phil Green, our measurement tool (CPI) is inaccurate and inflation is actually much higher than typically reported in the past 20 years. The way CPI is measured has changed, and some believe that governments are fudging the numbers. Green claims that the inflation rate in the U.S. was actually closer to 10 percent in 2010 if measured using traditional methods. The U.S. is not alone in this. Governments have changed the CPI equation many times in major industrialized nations. This is no secret. But informed individuals were questioning the very integrity of this key leading indicator.

Given all this complexity, we should not be surprised if economists have trouble accurately predicting whether inflation or deflation will be the next problem we face. Inflation definitely lurks in the background. If the crisis in confidence can be overcome, people will start spending again, and with all that money that governments dished out still in the system, demand could soar and inflation could become a big problem. On the other hand, if the recession is long and deep, deflation is a distinct possibility because there will be very little demand for goods and services, and that will cause prices to fall.

Questions for Discussion

1. Based on your own observations in the marketplace, do you believe we are in an inflationary or deflationary period?
2. Go to the Bank of Canada website and find the latest inflation figures. Based on the latest statistics, is inflation or deflation a bigger problem today?
3. What do you think of Phil Green's contention that the CPI has become a deceptive tool? Do you believe that governments are purposefully massaging the numbers? If so, explain why.

SCANLIFE