The Business Environment (BUSI 1015)

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NSCC Edition

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ECAMPUSONTARIO

This is a NSCC adapted version of the *Fundamentals of Business Canadian Edition*, written by Business Faculty from Ontario Colleges and eCampus Ontario Program Managers. The NSCC edition was written by Jules Fauteaux.

Contents

Acknowledgements

NSCC Edition

Nova Scotia Community College (NSCC) adopted this text in 2020. Contributors to the first NSCC edition include, Lynn MacGregor (NSCC Copyright Officer) and NSCC faculty including Jules Fauteux and Neil Cody. Chapters 3 and 7 were edited most significantly from the eCampus Ontario version. Other edits were not significant so “thank you” to e-Campus Ontario and Virginia Tech for their hard pioneering work!

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CHAPTERS

1. Foundations of Business

Learning Objectives

By the end of the chapter, you should be able to:

- Describe the concept of stakeholders and identify the stakeholder groups relevant to an organization
- Discuss and be able to apply the macro-business-environment model to an industry or emerging technology
- Explain other key terms related to this chapter including: entrepreneur; profit; revenue

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=34#h5p-4

Why Is Apple Successful?

In 1976 Steve Jobs and Steve Wozniak created their first computer, the Apple I.[1] They invested a mere $1,300 and set up business in Jobs' garage. Three decades later, their business—Apple Inc.—has become one of the world's most influential and successful companies. Jobs and Wozniak were successful entrepreneurs: those who take the risks and reap the rewards associated with starting a new business enterprise.

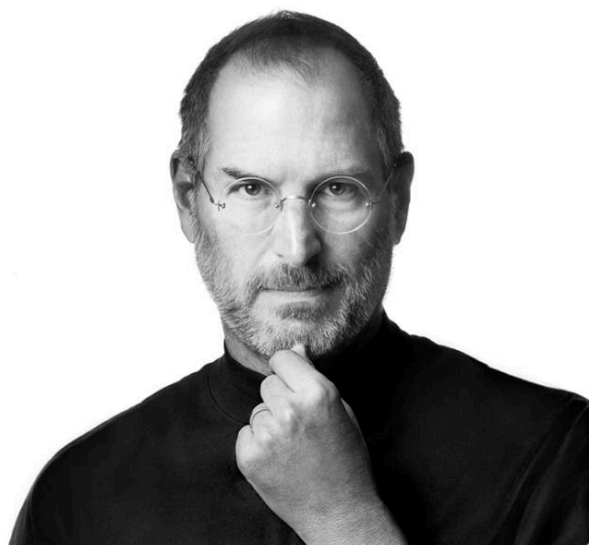

Figure 1.1: Steve Jobs 1955-2011 by segagman licensed CC BY | flickr

Did you ever wonder why Apple flourished while so many other young companies failed? How did it grow from a garage start-up to a company generating over $233 billion in sales in 2015? How was it able to transform itself from a nearly bankrupt firm to a multinational corporation with locations all around the world? You might conclude that it was the company's products, such as the Apple I and II, the Macintosh, or more recently its wildly popular iPod, iPhone, and iPad. Or, you could decide that it was its dedicated employees, management's wiliness to take calculated risks, or just plain luck – that Apple simply was in the right place at the right time.

Before you draw any conclusions about what made Apple what it is today and what will propel it into a successful future, you might like to learn more about Steve Jobs, the company's co-founder and former CEO. Jobs was instrumental in the original design of the Apple I and, after being ousted from his position with the company, returned to save the firm from destruction and lead it onto its current path. Growing up, Jobs had an interest in computers. He attended lectures at Hewlett-Packard after school and worked for the company during the summer months. He took a job at Atari after graduating from high school and saved his money to make a pilgrimage to India in search of spiritual enlightenment. Following his India trip, he attended Steve Wozniak's "Homebrew Computer Club" meetings, where the idea for building a personal computer surfaced.[2] "Many colleagues describe Jobs as a brilliant man who could be a great motivator and positively charming. At the same time his drive for perfection was so strong that employees who did not meet his demands [were] faced with blistering verbal attacks."[3] Not everyone at Apple appreciated Jobs' brilliance and ability to motivate. Nor did they all go along with his willingness to do whatever it took to produce an innovative, attractive, high-quality product. So at age thirty, Jobs found himself ousted from Apple by John Sculley, whom Jobs himself had hired as president of the company several years earlier. It seems that Sculley wanted to cut costs and thought it would be easier to do so without Jobs around. Jobs sold $20 million of his stock and went on a two-month vacation to figure out what he would do for the rest of his life. His solution: start a new personal computer company called NextStep. In 1993, he was invited back to Apple (a good thing, because neither his new company nor Apple was doing well).

Steve Jobs was definitely not known for humility, but he was a visionary and had a right to be proud of his accomplishments. Some have commented that "Apple's most successful days occurred with Steve Jobs at the helm."[4]

Jobs did what many successful CEOs and managers do: he learned, adjusted, and improvised.[5] Perhaps the most important statement that can be made about him is this: he never gave up on the company that once turned its back on him. So now you have the facts. Here's a multiple-choice question that you'll likely get right: Apple's success is due to (a) its products, (b) its customers, (c) luck, (d) its willingness to take risks, (e) Steve Jobs, or (f) some combination of these options.

Take a moment to consider this one company's impact on technology with its over 500 devices. Pop Chart Art (https://www.popchartlab.com/products/the-insanely-great-history-of-apple-devices) completed a comprehensive snapshot of the evolution of Apple.

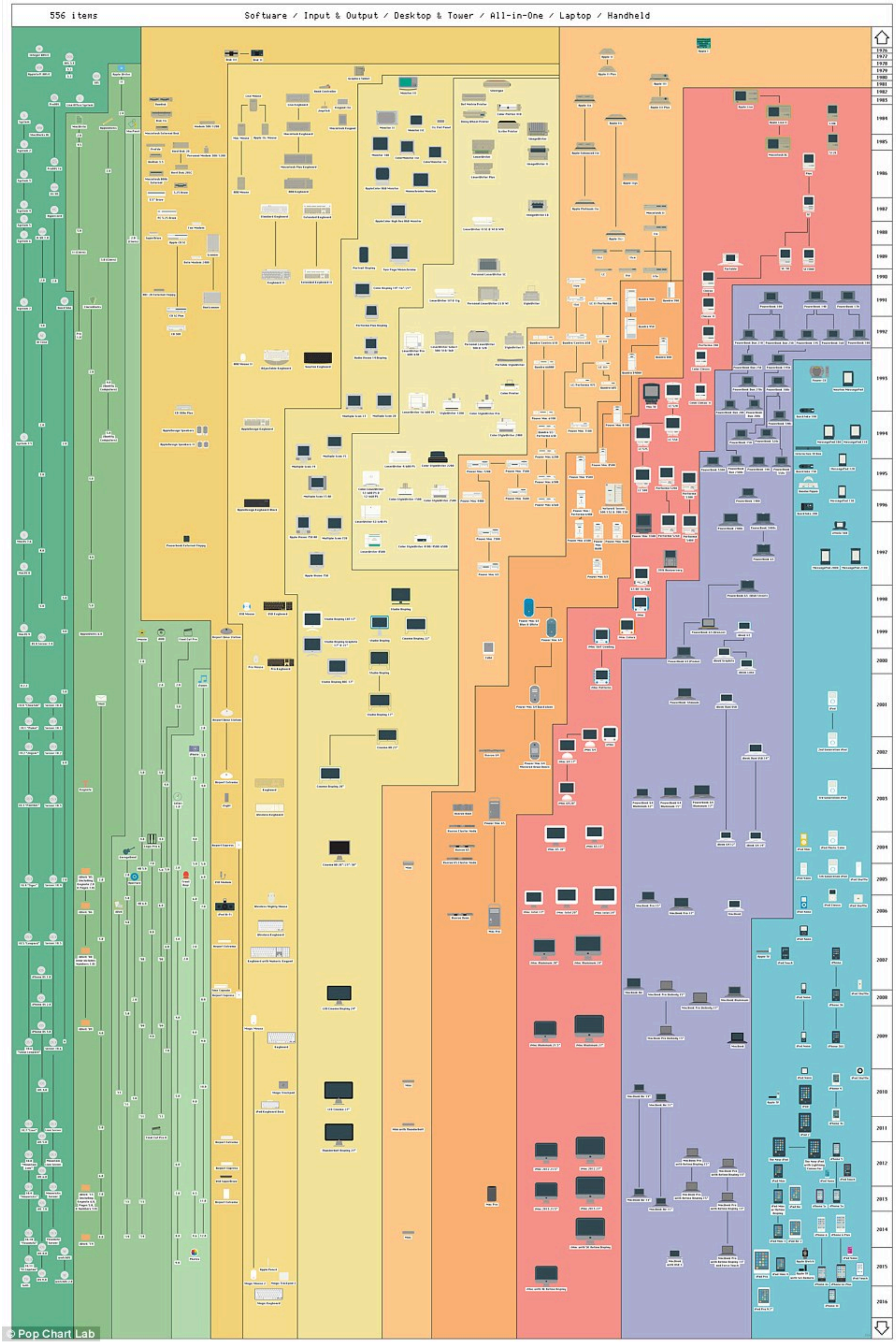

Figure 1.2: Source: Pop Chart Lab

Introduction

As the story of Apple suggests, today is an interesting time to study business. Advances in technology are bringing rapid changes in the ways we produce and deliver goods and services. The Internet and other improvements in communication (such as smartphones, video conferencing, and social networking) now affect the way we do business. Companies are expanding international operations, and the workforce is more diverse than ever. Corporations are being held responsible for the behavior of their executives, and more people share the opinion that companies should be good corporate citizens. Because of the role they played in the worst financial crisis since the Great Depression, businesses today face increasing scrutiny and negative public sentiment.[6]

Economic turmoil that began in the housing and mortgage industries as a result of troubled subprime mortgages quickly spread to the rest of the economy. In 2008, credit markets froze up and banks stopped making loans. Lawmakers tried to get money flowing again by passing a $700 billion Wall Street bailout, now-cautious banks became reluctant to extend credit. Without money or credit, consumer confidence in the economy dropped and consumers cut back on spending. Unemployment rose as troubled companies shed the most jobs in five years, and 760,000 Americans marched to the unemployment lines.[7] The stock market reacted to the financial crisis and its stock prices dropped by 44 percent while millions of Americans watched in shock as their savings and retirement accounts took a nosedive. In fall 2008, even Apple, a company that had enjoyed strong sales growth over the past five years, began to cut production of its popular iPhone. Without jobs or cash, consumers would no longer flock to Apple's fancy retail stores or buy a prized iPhone.[8] Since then, things have turned around for Apple, which continues to report blockbuster sales and profits. But not all companies or individuals are doing so well. The economy is still struggling, unemployment is high (particularly for those ages 16 to 24), and home prices have not fully rebounded from the crisis.

As you go through the course with the aid of this text, you'll explore the exciting world of business. We'll introduce you to the various activities in which business people engage—accounting, finance, information technology, management, marketing, and operations. We'll help you understand the roles that these activities play in an organization, and we'll show you how they work together. We hope that by exposing you to the things that business people do, we'll help you decide whether business is right for you and, if so, what areas of business you'd like to study further.

Getting Down to Business

A business is any activity that provides goods or services to consumers for the purpose of making a profit. Be careful not to confuse the terms revenue and profit. Revenue represents the funds an enterprise receives in exchange for its goods or services. Profit is what's left (hopefully) after all the bills are paid. When Steve Jobs and Steve Wozniak launched the Apple I, they created Apple Computer in Jobs' family garage with the hope of making a profit. Before we go on, let's make a couple of important distinctions concerning the terms in our definitions. First, whereas Apple produces and sells goods (Mac, iPhone, iPod, iPad, Apple Watch), many businesses provide services. Your bank is a service company, as is your Internet provider. Hotels, airlines, law firms, movie theaters, and hospitals are also service companies. Many companies provide both goods and services. For example, your local car dealership sells goods (cars) and also provides services (automobile repairs). Second, some organizations are not set up to make profits for individual stakeholders. Many are established to provide social or educational services for the entire public. Such not-for profit (or nonprofit), organizations include the United Way of America, Habitat for Humanity, the Boys and Girls Clubs, the Sierra Club, the American Red Cross, and many colleges and universities. Most of these organizations, however, function in much the same way as a business. They establish goals and work to meet them in an effective, efficient manner. Thus, most of the business principles introduced in this text also apply to nonprofits.

Business Participants and Activities

Let's begin our discussion of business by identifying the main participants of business and the functions that most businesses perform. Then we'll finish this section by discussing the external factors that influence a business' activities.

Participants

Every business must have one or more owners whose primary role is to invest money in the business. When a business is being started, it's generally the owners who polish the business idea and bring together the resources (money and people) needed to turn the idea into a business. The owners also hire employees to work for the company and help it reach its goals. Owners and employees depend on a third group of participants— customers. Ultimately, the goal of any business is to satisfy the needs of its customers in order to generate a profit for the owners.

Stakeholders

Consider your favorite restaurant. It may be an outlet or franchise of a national chain (more on franchises in a later chapter) or a local "mom and pop shop" without affiliation to a larger entity. Whether national or local, every business has stakeholders – those with a legitimate interest in the success or failure of the business and the policies it adopts. Stakeholders include customers, vendors, employees, landlords, bankers, and others (see Figure 1.3). Other stakeholders include the general public, the environment and all the various government departments which impact the business. All have a keen interest in how the business operates, in most cases for obvious reasons. If the business fails, employees will need new jobs, vendors will need new customers, and banks may have to write off loans they made to the business. Stakeholders do not always see things the same way – their interests sometimes conflict with each other. For example, lenders are more likely to appreciate high profit margins that ensure the loans they made will be repaid, while customers would probably appreciate the lowest possible prices. Pleasing stakeholders can be a real balancing act for any company.

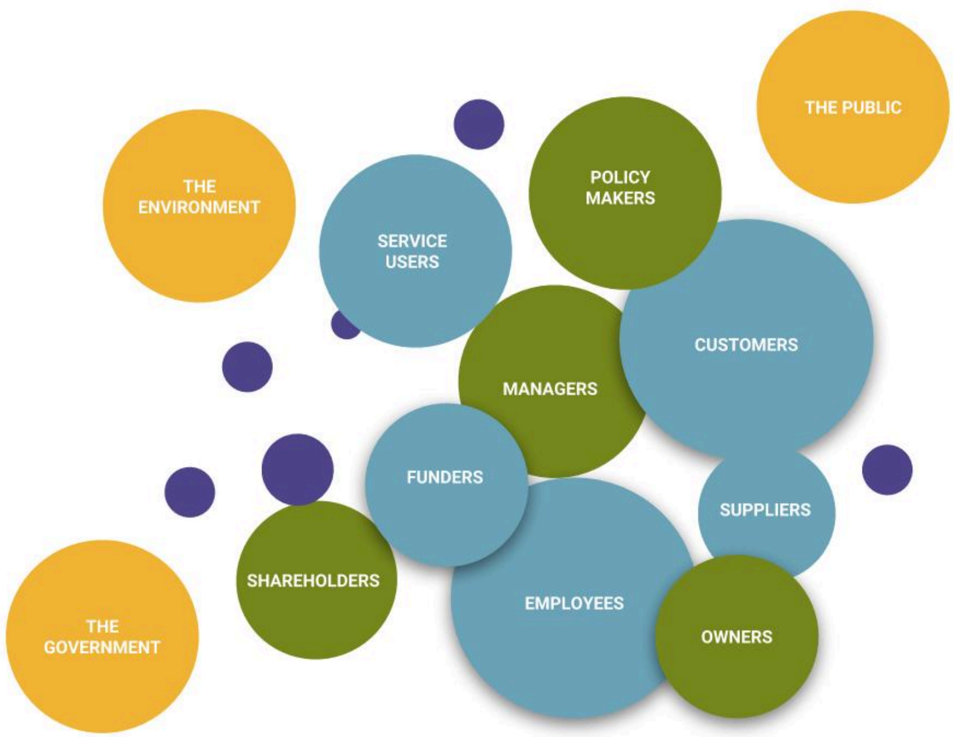

Figure 1.3

Functional Areas of Business

The activities needed to operate a business can be divided into a number of functional areas. Examples include: human resources, operations, marketing, accounting, finance and information technology. Let's briefly explore each of these areas.

Human Resources

HR managers are responsible for ensuring that the organization has all of the skills and capabilities necessary to run the business. HR managers develop staffing plans, recruit and select new employees, monitor the performance management process, and develop succession plans for advancement and replacement. They develop standards for compensation and benefits and assist managers with staff issues.

Operations

All companies must convert resources (labour, materials, money, information, and so forth) into goods or services. Some companies, such as Apple, convert resources into tangible products—Macs, iPhones, etc. Others, such as hospitals, convert resources into intangible products — e.g., health care. The person who designs and oversees the transformation of resources into goods or services is called an operations manager. This individual is also responsible for ensuring that products are of high quality. In many organizations, operations management includes managing the supply chain which controls the delivery of raw materials and the distribution of finished goods.

Marketing

Marketing consists of everything that a company does to identify customers' needs (i.e. market research) and design products to meet those needs. Marketers develop the benefits and features of products, including price and quality. They also decide on the best method of delivering products and the best means of promoting them to attract and keep customers. They manage relationships with customers and make them aware of the organization's desire and ability to satisfy their needs.

Accounting

Managers need accurate, relevant and timely financial information, which is provided by accountants. Accountants measure, summarize, and communicate financial and managerial information and advise other managers on financial matters. There are two fields of accounting. Financial accountants prepare financial statements to help users, both inside and outside the organization, assess the financial strength of the company. Managerial accountants prepare information, such as reports on the cost of materials used in the production process, for internal use only.

Finance

Finance involves planning for, obtaining, and managing a company's funds. Financial managers address such questions as the following: How much money does the company need? How and where will it get the necessary money? How and when will it pay the money back? What investments should be made in plant and equipment? How much should be spent on research and development? Good financial management is particularly important when a company is first formed because new business owners usually need to borrow money to get started.

Information Technology

Information is one of the critical assets of most businesses. Businesses such as Facebook are entirely information based businesses. Information technology (IT) managers are concerned with building computer and network infrastructure, implementing security protocols, and developing user interfaces and apps for customers. Usually, there is a high level of integration between the businesses website or application and other departments within the business, such as finance, marketing and operations. Often, businesses must develop interfaces to send and receive information from other companies, including suppliers, logistics and shipping suppliers.

External Forces that Influence Business Activities

Apple and other businesses don't operate in a vacuum: they're influenced by a number of external factors. These include the economy, government, consumer trends, technological developments, public pressure to act as good corporate citizens, and other factors. Collectively, these forces constitute what is known as the "macro environment" – essentially the big picture world outside over which the business exerts very little if any control.

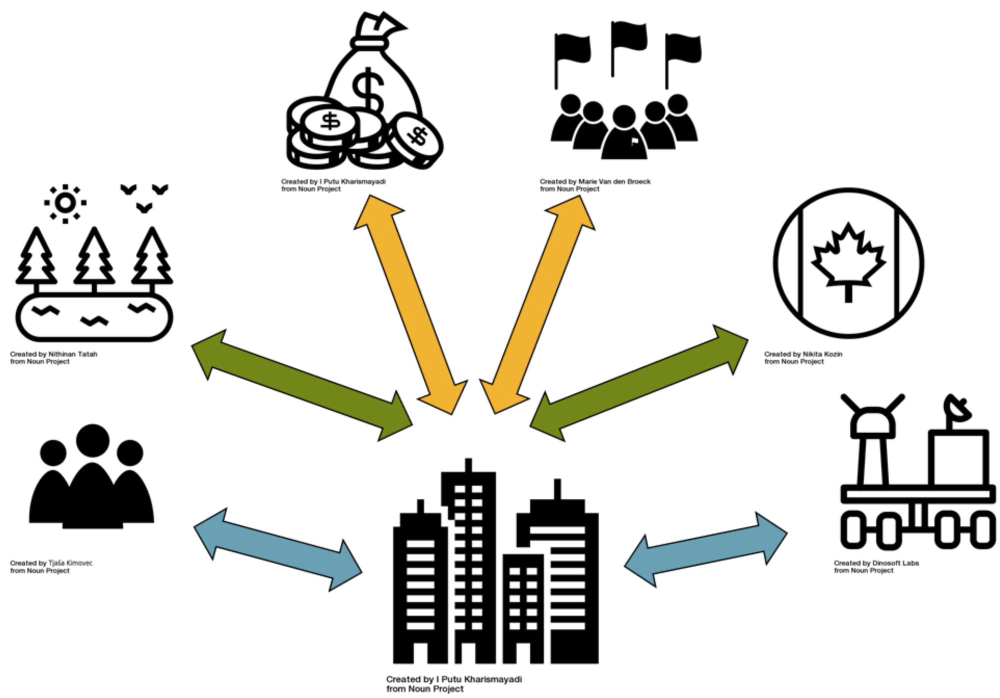

Figure 1.4: The company surrounded by its environmental forces: demographic, natural, economic, political, cultural, and technological. Source: All icons from the Noun Project

"Business and Its Environment" sums up the relationship between a business and the external forces that influence its activities. One industry that's clearly affected by all these factors is the fast-food industry. Companies such as Taco Bell, McDonald's, Tim Hortons and others all compete in this industry. Here are a few statements to show the way external factors impact business. For instance, a strong economy means people have more money to eat out. Food standards are monitored by a government agency, the Canadian Food and Drug Inspection Agency at the federal level with entities at both the provincial and municipal levels following through with adherence. Preferences for certain types of foods are influenced by consumer trends (fast food companies are being pressured to make their menus healthier).

This example shows the large scale impact of external forces. The Ministry of Health and Long Term Care's Newsroom on December 30, 2016 (https://news.ontario.ca/en/release/43239/calorie-amounts-coming-to-ontario-menus-beginning-january-1st"):

> Starting January 1, 2017 Ontario will be the first province in Canada to require food service providers with 20 or more locations in the province — such as restaurants, coffee shops, convenience stores, grocery stores and movie theatres — to include the number of calories for each food and beverage item on their menus, labels or tags.[9]

Finally, a number of decisions made by the industry result from its desire to be a good corporate citizen. For example, several fast-food chains have responded to environmental concerns by eliminating Styrofoam containers.[10]

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=34#h5p-5

Of course, all industries are impacted by external factors, not just the food industry. As people have become more conscious of the environment, they have begun to choose new technologies, like all-electric cars to replace those that burn fossil fuels. Both established companies, like Nissan with its Nissan Leaf, and brand new companies like Tesla have entered the market for all-electric vehicles. While the market is still small, it is expected to grow at a compound annual growth rate of 19.2% between 2013 and 2019.[11]

As you move through this text, you'll learn more about these external influences on business.

Key Takeaways / Important Terms and Concepts

1. The main participants in a business are its owners, employees, and customers.
2. Every business must consider its stakeholders, and their sometimes conflicting interests, when making decisions.
3. The activities needed to run a business can be divided into functional areas. The business functions correspond fairly closely to many majors found within a typical college of business.
4. Businesses are influenced by such external factors as the economy, government, and other forces external to the business.

2. Economics and Business

Learning Objectives

By the end of the chapter, you should be able to:

1. Describe the foundational philosophies of capitalism and socialism.
2. Discuss private property rights and why they are key to economic development.
3. Discuss the concept of GDP (gross domestic product).
4. Explain the difference(s) between fiscal and monetary policy.
5. Discuss the concept of the unemployment rate measurement.
6. Discuss the concepts of inflation and deflation.
7. Explain other key terms related to this chapter including: supply; demand; equilibrium price; monopoly; recession; depression.

Show What You Know

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What is Economics?

To appreciate how a business functions, we need to know something about the economic environment in which it operates. We begin with a definition of economics and a discussion of the resources used to produce goods and services.

Resources: Inputs and Outputs

Economics is the study of how individuals, businesses, governments and nations allocate their limited resources to satisfy their unlimited wants and needs. The allocation of resources is concerned with the production, distribution, and consumption of goods and services. Resources are the inputs used to produce outputs. Resources may include any or all of the following and their connections with one another:

- Land and other natural resources
- Labour (physical and mental)
- Capital, including buildings and equipment
- Entrepreneurship
- Knowledge

Resources are combined to produce goods and services. Land and natural resources provide the needed raw materials. Labour transforms raw materials into goods and services. Capital (equipment, buildings, vehicles, cash, and so forth) are needed for the production process. Entrepreneurship provides the skill, drive and creativity needed to bring the other resources together to produce a good or service to be sold to the marketplace.

Because a business uses resources to produce things, we also call these resources factors of production. The factors of production used to produce a shirt would include the following:

- The land that the shirt factory sits on, the electricity used to run the plant, and the raw cotton from which the shirts are made
- The labourers who make the shirts
- The factory and equipment used in the manufacturing process, as well as the money needed to operate the factory
- The entrepreneurship skills and production knowledge used to coordinate the other resources to make the shirts and distribute them to the marketplace

Input and Output Markets

Many of the factors of production are provided to businesses by households. For example, households provide businesses with labour (as workers), land and buildings (as landlords), and capital (as investors). In turn, businesses pay households for these resources by providing them with income, such as wages, rent, and interest. The resources obtained from households are then used by businesses to produce goods and services, which are sold to provide businesses with revenue. The revenue obtained by businesses is then used to buy additional resources, and the cycle continues. This is described in Figure 2.1, "The Circular Flow of Inputs and Outputs", which illustrates the dual roles of households and businesses:

- Households not only provide factors of production (or resources) but also consume goods and services
- Businesses not only buy resources but also produce and sell both goods and services

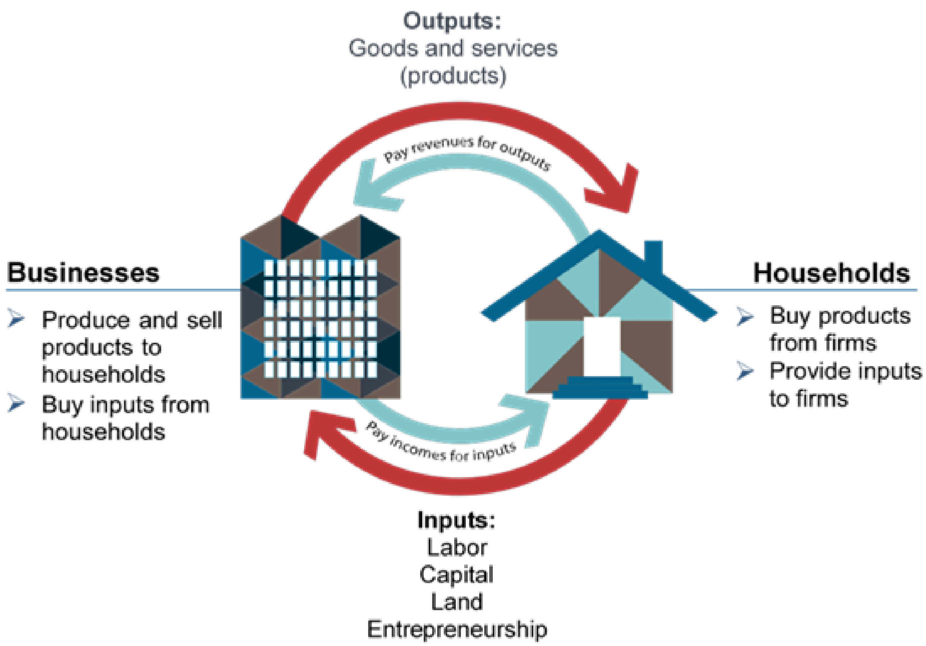


Figure 2.1: The Circular Flow of Inputs and Outputs

Economic Systems

Economists study the interactions between households and businesses and look at the ways in which the factors of production are combined to produce the goods and services that people need. Basically, economists try to answer three sets of questions:

1. What goods and services should be produced to meet consumers' needs? In what quantity? When?
2. How should goods and services be produced? Who should produce them, and what resources, including technology, should be combined to produce them?
3. Who should receive the goods and services produced? How should they be allocated among consumers? The answers to these questions depend on a country's economic system—the means by which a society (households, businesses, and government) makes decisions about allocating resources to produce products and about distributing those products. The degree to which individuals and business owners, as opposed to the government, enjoy freedom in making these decisions varies according to the type of economic system.

Generally speaking, economic systems can be divided into two systems: planned systems and free market systems.

Planned Systems

In a planned system, the government exerts control over the allocation and distribution of all or some goods and services. The system with the highest level of government control is communism. In theory, a communist economy is one in which the government owns all or most enterprises. Central planning by the government dictates which goods or services are produced, how they are produced, and who will receive them. In practice, pure communism is practically nonexistent today, and only a few countries (notably North Korea and Cuba) operate under rigid, centrally planned economic systems.

Under socialism, industries that provide essential services, such as utilities, banking, and health care, may be government owned. Some businesses may also be owned privately. Central planning allocates the goods and services produced by government-run industries and tries to ensure that the resulting wealth is distributed equally. In contrast, privately owned companies are operated for the purpose of making a profit for their owners. In general, workers in socialist economies work fewer hours, have longer vacations, and receive more health care, education, and child-care benefits than do workers in capitalist economies. To offset the high cost of public services, taxes are generally steep. Examples of countries that lean towards a socialistic approach include Venezuela, Sweden, and France.

Free Market System

The economic system in which most businesses are owned and operated by individuals is the free market system, also known as capitalism. In a free market economy, competition dictates how goods and services will be allocated. Business is conducted with more limited government involvement concentrated on regulations that dictate how businesses are permitted to operate. A key aspect of a free market system is the concept of private property rights, which means that business owners can expect to own their land, buildings, machines, etc., and keep the majority of their profits, except for taxes. The profit incentive is a key driver of any free market system. The economies of the United States and other countries, such as Japan, are based on capitalism. However, a purely capitalistic economy is as rare as one that is purely communist. Imagine if a service such as police protection, one provided by government in the United States, were instead allocated based on market forces. The ability to pay would then become a key determinant in who received these services, an outcome that few in American society would consider to be acceptable.

How Economic Systems Compare

In comparing economic systems, it can be helpful to think of a continuum with communism at one end and pure capitalism at the other, as in Figure 2.2, "Economic Systems". As you move from left to right, the amount of government control over business diminishes. So, too, does the level of social services, such as health care, child-care services, social security, and unemployment benefits. Moving from left to right, taxes are correspondingly lower as well.

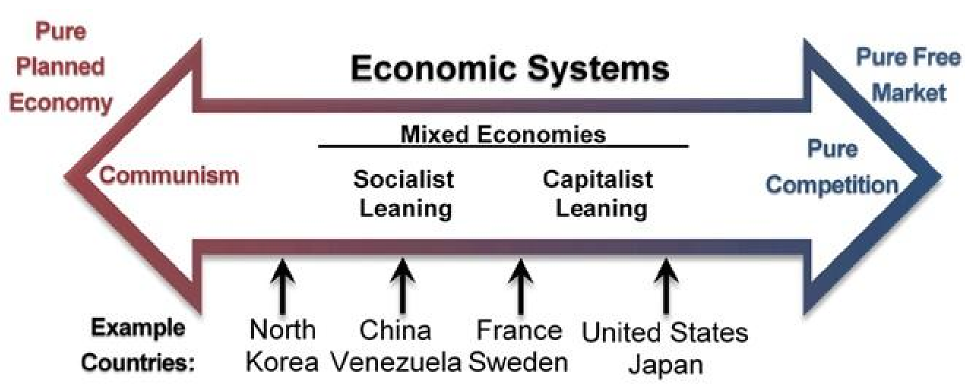


Figure 2.2: Wikimedia Commons | Designed for Virginia Tech by B. Craig licensed CC BY

Mixed Market Economies

Though it's possible to have a pure communist system, or a pure capitalist (free market) system, in reality many economic systems are mixed. A mixed market economy relies on both markets and the government to allocate resources. In practice, most economies are mixed, with a leaning towards either free market or socialistic principles, rather than being purely one or the other. Some previously communist economies, such as those of Eastern Europe and China, are becoming more mixed as they adopt more capitalistic characteristics and convert businesses previously owned by the government to private ownership through a process called privatization. By contrast, Venezuela is a country that has moved increasingly towards socialism, taking control of industries such as oil and media through a process called nationalization.

The Canadian Economic System

Like most countries, Canada features a mixed market system much like its neighbour to the south: though the Canadian and U.S. economic systems are primarily free market systems, the federal government controls some basic services, such as the postal service and air traffic control. The Canadian economy also has some characteristics of a socialist system, such as providing social security retirement benefits to retired workers or free health care to its population.

The free market system was espoused by Adam Smith in his book The Wealth of Nations (https://en.wikisource.org/wiki/The_Wealth_of_Nations), published in 1776. According to Smith, competition alone would ensure that consumers received the best products at the best prices. In the kind of competition he assumed, a seller who tries to charge more for his product than other sellers would not be able to find any buyers. A job-seeker who asks more than the going wage won't be hired. Because the "invisible hand" of competition will make the market work effectively, there won't be a need to regulate prices or wages. Almost immediately, however, a tension developed among free market theorists between the principle of laissez-faire—leaving things alone—and government intervention. Today, it's common for the Canadian government to intervene in the operation of the economic system. For example, government exerts influence on the food and pharmaceutical industries through Canada's Food and Drug Act and Regulations, which protect consumers by preventing unsafe or mislabeled products from reaching the market.

To appreciate how businesses operate, we must first get an idea of how prices are set in competitive markets. The next section, "Perfect Competition and Supply and Demand," begins by describing how markets establish prices in an environment of perfect competition.

Perfect Competition and Supply and Demand

Under a mixed economy, such as we have in Canada, businesses make decisions about which goods to produce or services to offer and how they are priced. Because there are many businesses making goods or providing services, customers can choose among a wide array of products. The competition for sales among businesses is a vital part of our economic system. Economists have identified four types of competition—perfect competition, monopolistic competition, oligopoly, and monopoly. We'll introduce the first of these—perfect competition—in this section and cover the remaining three in the following section.

Perfect Competition

Perfect competition exists when there are many consumers buying a standardized product from numerous small businesses. Because no seller is big enough or influential enough to affect price, sellers and buyers accept the going price. For example, when a commercial fisher brings his fish to the local market, he has little control over the price he gets and must accept the going market price.

The Basics of Supply and Demand

To appreciate how perfect competition works, we need to understand how buyers and sellers interact in a market to set prices. In a market characterized by perfect competition, price is determined through the mechanisms of supply and demand. Prices are influenced both by the supply of products from sellers and by the demand for products by buyers.

To illustrate this concept, let's create a supply and demand schedule for one particular good sold at one point in time. Then we'll define demand and create a demand curve and define supply and create a supply curve. Finally, we'll see how supply and demand interact to create an equilibrium price—the price at which buyers are willing to purchase the amount that sellers are willing to sell.

Demand and the Demand Curve

Demand is the quantity of a product that buyers are willing to purchase at various prices. The quantity of a product that people are willing to buy depends on its price. You're typically willing to buy less of a product when prices rise and more of a product when prices fall. Generally speaking, we find products more attractive at lower prices, and we buy more at lower prices because our income goes further.

Using this logic, we can construct a demand curve that shows the quantity of a product that will be demanded at different prices. Let's assume that the diagram "The Demand Curve" in Figure 2.3 represents the daily price and quantity of apples sold by farmers at a local market. Note that as the price of apples goes down, buyers' demand goes up. Thus, if a pound of apples sells for $0.80, buyers will be willing to purchase only fifteen hundred pounds per day. But if apples cost only $0.60 a pound, buyers will be willing to purchase two thousand pounds. At $0.40 a pound, buyers will be willing to purchase twenty-five hundred pounds.

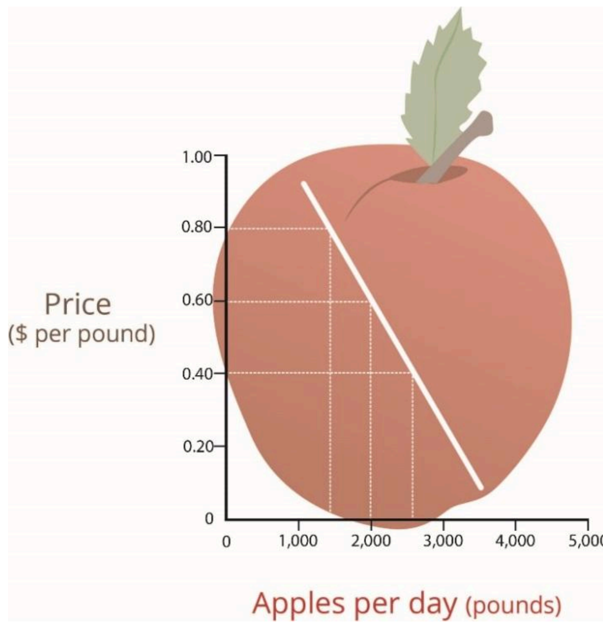


Figure 2.3: The Demand Curve

Supply and the Supply Curve

Supply is the quantity of a product that sellers are willing to sell at various prices. The quantity of a product that a business is willing to sell depends on its price. Businesses are more willing to sell a product when the price rises and less willing to sell it when prices fall. Again, this fact makes sense: businesses are set up to make profits, and there are larger profits to be made when prices are high.

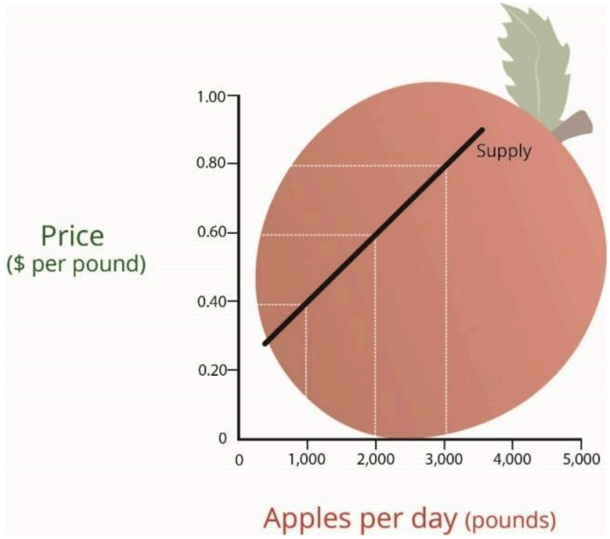


Figure 2.4: The Supply Curve

Now we can construct a supply curve that shows the quantity of apples that farmers would be willing to sell at different prices, regardless of demand. As you can see in "The Supply Curve" in Figure 2.4, the supply curve goes in the opposite direction from the demand curve: as prices rise, the quantity of apples that farmers are willing to sell also goes up. The supply curve shows that farmers are willing to sell only a thousand pounds of apples when the price is $0.40 a pound, two thousand pounds when the price is $0.60, and three thousand pounds when the price is $0.80.

Equilibrium Price

We can now see how the market mechanism works under perfect competition. We do this by plotting both the supply curve and the demand curve on one graph, as we've done in Figure 2.5, "The Equilibrium Price". The point at which the two curves intersect is the equilibrium price.

You can see in "The Equilibrium Price" that the supply and demand curves intersect at the price of $0.60 and quantity of two thousand pounds. Thus, $0.60 is the equilibrium price: at this price, the quantity of apples demanded by buyers equals the quantity of apples that farmers are willing to supply. If a single farmer tries to charge more than $0.60 for a pound of apples, he won't sell very many because other suppliers are making them available for less. As a result, his profits will go down. If, on the other hand, a farmer tries to charge less than the equilibrium price of $0.60 a pound, he will sell more apples but his profit per pound will be less than at the equilibrium price. With profit being the motive, there is no incentive to drop the price.

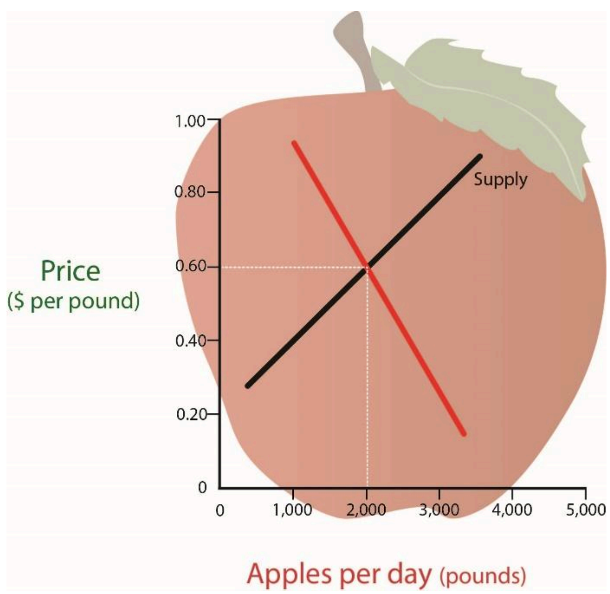


Figure 2.5: The Equilibrium Price

What have you learned in this discussion? Without outside influences, markets in an environment of perfect competition will arrive at an equilibrium point at which both buyers and sellers are satisfied. But you must be aware that this is a very simplistic example. Things are much more complex in the real world. For one thing, markets rarely operate without outside influences. Sometimes, sellers supply more of a product than buyers are willing to purchase; in that case, there's a surplus. Sometimes, they don't produce enough of a product to satisfy demand; then we have a shortage.

Circumstances also have a habit of changing. What would happen, for example, if incomes rose and buyers were willing to pay more for apples? The demand curve would change, resulting in an increase in equilibrium price. This outcome makes intuitive sense: as demand increases, prices will go up. What would happen if apple crops were larger than expected because of favorable weather conditions? Farmers might be willing to sell apples at lower prices rather than letting part of the crop spoil. If so, the supply curve would shift, resulting in another change in equilibrium price: the increase in supply would bring down prices.

Monopolistic Competition, Oligopoly, and Monopoly

As mentioned previously, economists have identified four types of competition—perfect competition, monopolistic competition, oligopoly, and monopoly. Perfect competition was discussed in the last section; we'll cover the remaining three types of competition here.

Table 2.1

Characteristic	**Four Major Market Structures**			
	Perfect Competition	**Monopolistic Competition**	**Oligopoly**	**Pure Monopoly**
Number of firms	Very many	Many	A few	One
Types of product	Homogeneous	Differentiated	Homogeneous or differentiated	Homogeneous
Barriers to entry or exit from industry	No substantial barriers	Minor barriers	Considerable barriers	Extremely great barriers
Examples	Agriculture	Retail trade	Banking	Public utilities

Monopolistic Competition

In monopolistic competition, we still have many sellers (as we had under perfect competition). Now, however, they don't sell identical products. Instead, they sell differentiated products—products that differ somewhat, or are perceived to differ, even though they serve a similar purpose. Products can be differentiated in a number of ways, including quality, style, convenience, location, and brand name. Some people prefer Coke over Pepsi, even though the two products are quite similar. But what if there was a substantial price difference between the two? In that case, buyers could be persuaded to switch from one to the other. Thus, if Coke has a big promotional sale at a supermarket chain, some Pepsi drinkers might switch (at least temporarily).

How is product differentiation accomplished? Sometimes, it's simply geographical; you probably buy gasoline at the station closest to your home regardless of the brand. At other times, perceived differences between products are promoted by advertising designed to convince consumers that one product is different from an- other—and better than it. Regardless of customer loyalty to a product, however, if its price goes too high, the seller will lose business to a competitor. Under monopolistic competition, therefore, companies have only limited control over price.

Oligopoly

Oligopoly means few sellers. In an oligopolistic market, each seller supplies a large portion of all the products sold in the marketplace. In addition, because the cost of starting a business in an oligopolistic industry is usually high, the number of firms entering it is low. Companies in oligopolistic industries include such large-scale enterprises as automobile companies and airlines. As large firms supplying a sizable portion of a market, these companies have some control over the prices they charge. But there's a catch: because products are fairly similar, when one company lowers prices, others are often forced to follow suit to remain competitive. You see this practice all the time in the airline industry: When American Airlines announces a fare decrease, Continental, United Airlines, and others do likewise. When one automaker offers a special deal, its competitors usually come up with similar promotions.

Monopoly

In terms of the number of sellers and degree of competition, a monopoly lies at the opposite end of the spectrum from perfect competition. In perfect competition, there are many small companies, none of which can control prices; they simply accept the market price determined by supply and demand. In a monopoly, however, there's only one seller in the market. The market could be a geographical area, such as a city or a regional area, and doesn't necessarily have to be an entire country.

There are few monopolies in the United States because the government limits them. Most fall into one of two categories: natural and legal. Natural monopolies include public utilities, such as electricity and gas suppliers. Such enterprises require huge investments, and it would be inefficient to duplicate the products that they provide. They inhibit competition, but they're legal because they're important to society. In exchange for the right to conduct business without competition, they're regulated. For instance, they can't charge whatever prices they want, but they must adhere to government-controlled prices. As a rule, they're required to serve all customers, even if doing so isn't cost efficient.

A legal monopoly arises when a company receives a patent giving it exclusive use of an invented product or process. Patents are issued for a limited time, generally twenty years.[1] During this period, other companies can't use the invented product or process without permission from the patent holder. Patents allow companies a certain period to recover the heavy costs of researching and developing products and technologies. A classic example of a company that enjoyed a patent-based legal monopoly is Polaroid, which for years held exclusive ownership of instant-film technology.[2] Polaroid priced the product high enough to recoup, over time, the high cost of bringing it to market. Without competition, in other words, it enjoyed a monopolistic position in regard to pricing.

Measuring the Health of the Economy

Every day, we are bombarded with economic news (at least if you watch the business news stations). We're told about things like unemployment, home prices, and consumer confidence trends. As a student learning about business, and later as a business manager, you need to understand the nature of the Canadian economy and the terminology that we use to describe it. You need to have some idea of where the economy is heading, and you need to know something about the government's role in influencing its direction.

Economic Goals

The world's economies share three main goals:

- Growth
- High employment
- Price stability

Let's take a closer look at each of these goals, both to find out what they mean and to show how we determine whether they're being met.

Economic Growth

One purpose of an economy is to provide people with goods and services—cars, computers, video games, houses, rock concerts, fast food, amusement parks. One way in which economists measure the performance of an economy is by looking at a widely used measure of total output called the gross domestic product (GDP). The GDP is defined as the market value of all goods and services produced by the economy in a given year. The GDP includes only those goods and services produced domestically; goods produced outside the country are excluded. The GDP also includes only those goods and services that are produced for the final user; intermediate products are excluded. For example, the silicon chip that goes into a computer (an intermediate product) would not count directly because it is included when the finished computer is counted. By itself, the GDP doesn't necessarily tell us much about the direction of the economy. But change in the GDP does. If the GDP (after adjusting for inflation, which will be discussed later) goes up, the economy is growing. If it goes down, the economy is contracting. There is some debate amongst economists that GDP provides the most accurate measure of an economy's performance. Many economists believe that GDP per capita, which is the measure of total production of goods and services divided by the number of households, is a better indicator of an economy's performance. For example, according to The World Bank (https://www.worldbank.org/), as of 2017, India's GDP ranked 7th in the world at $2.439 trillion (USD) while Canada's GDP ranked 10th at $1.640 trillion (USD). However, as of 2017, Canada's GDP per capita ranks 18th at $44,773 per household, compared to India's GDP per capita which ranked 142nd in the world at $1,852 per household.

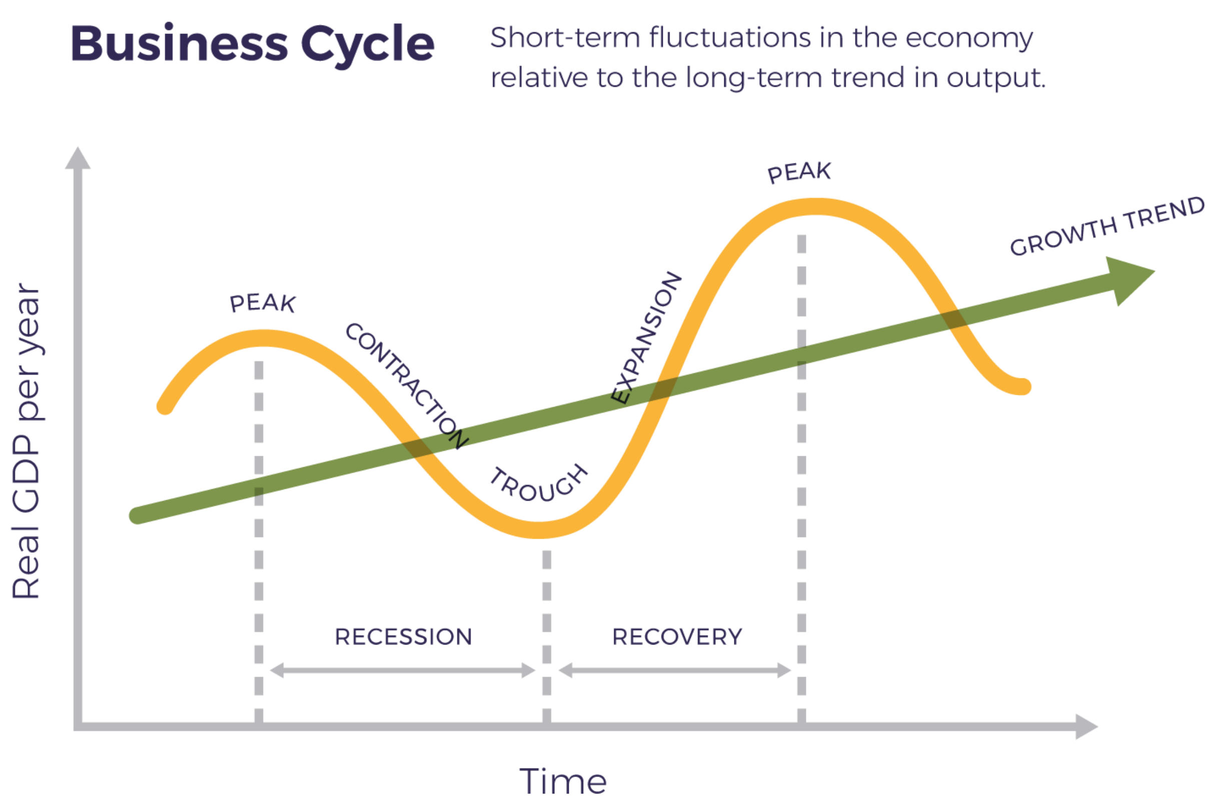
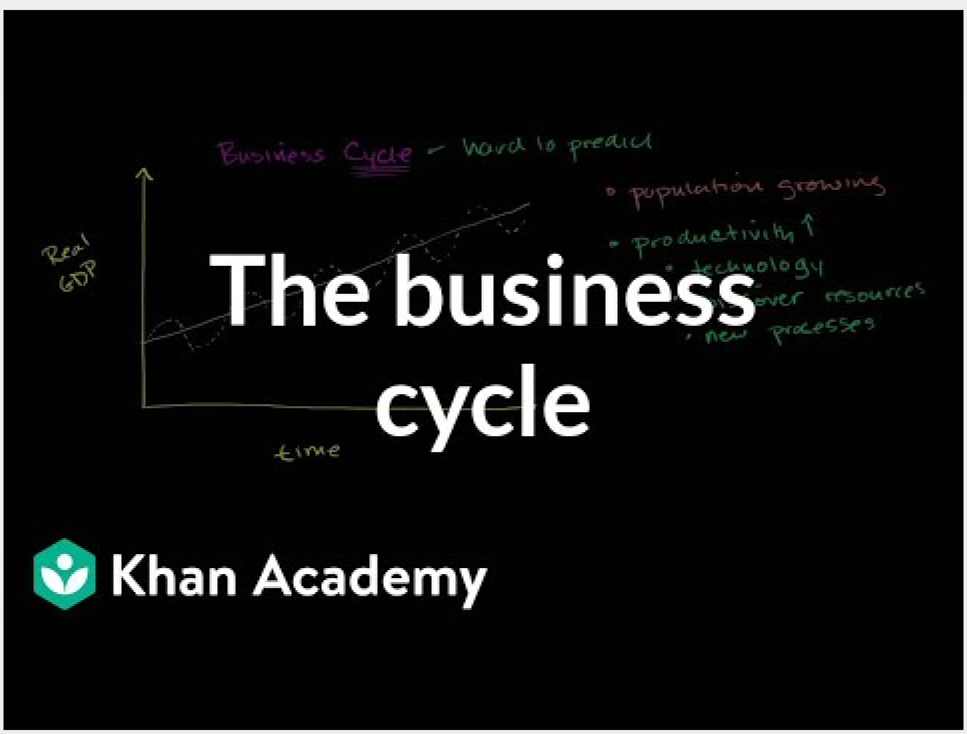


Figure 2.6

The economic ups and downs resulting from expansion and contraction constitute the business cycle. Similar to a product lifecycle, as a business cycle introduces new products, those products grow, mature and decline, when all business cycles in an economy are combined it creates an economy's business cycle. A typical cycle runs from three to five years but could last much longer. Though typically irregular, a cycle can be divided into four general phases of prosperity, recession, depression (which the cycle generally skips), and recovery:

- During prosperity, the economy expands, unemployment is low, incomes rise, and consumers buy more products. Businesses respond by increasing production and offering new and better products.
- Eventually, however, things slow down. GDP decreases, unemployment rises, and because people have less money to spend, business revenues decline. This slowdown in economic activity is called a recession.
- Economists often say that we're entering a recession when GDP goes down for two consecutive quarters.
- Generally, a recession is followed by a recovery or expansion in which the economy starts growing again.
- If, however, a recession lasts a long time (perhaps a decade or so), while unemployment remains very high and production is severely curtailed, the economy could sink into a depression. Unlike for the term recession, economists have not agreed on a uniform standard for what constitutes a depression, though they are generally characterized by their duration. Though not impossible, it's unlikely that the United States will experience another severe depression like that of the 1930s. The federal government has a number of economic tools (some of which we'll discuss shortly) with which to fight any threat of a depression.

If you want or need a more interactive examples of the business cycle, this 10 minute video provides more details:



A YouTube element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=44

The Unemployment Rate

Statistics Canada tracks unemployment and reports the unemployment rate: the percentage of the labour force that's unemployed and actively seeking work. The unemployment rate is an important measure of economic health. It goes up during recessionary periods because companies are reluctant to hire workers when demand for goods and services is low. Conversely, it goes down when the economy is expanding and there is high demand for products and workers to supply them.

"The Canadian Unemployment Rate, 1946–2015" (Figure 2.7) traces the Canadian unemployment rate between 1946 and 2015. Please be aware that there are multiple measures of unemployment and that this graph is based on what is known as R4, the most commonly used measurement and is comparable to the U.S. unemployment measure, U3. Another measurement, R8, is considered to provide a broader picture of unemployment in Canada and includes unemployed workers that are discouraged by their job search, involuntary part-time workers and those unemployed workers that are awaiting confirmation for new work. Since by definition, R8 is always higher than R4, it is likely that R4 is discussed more often because it paints a more favourable, if not completely accurate, picture.

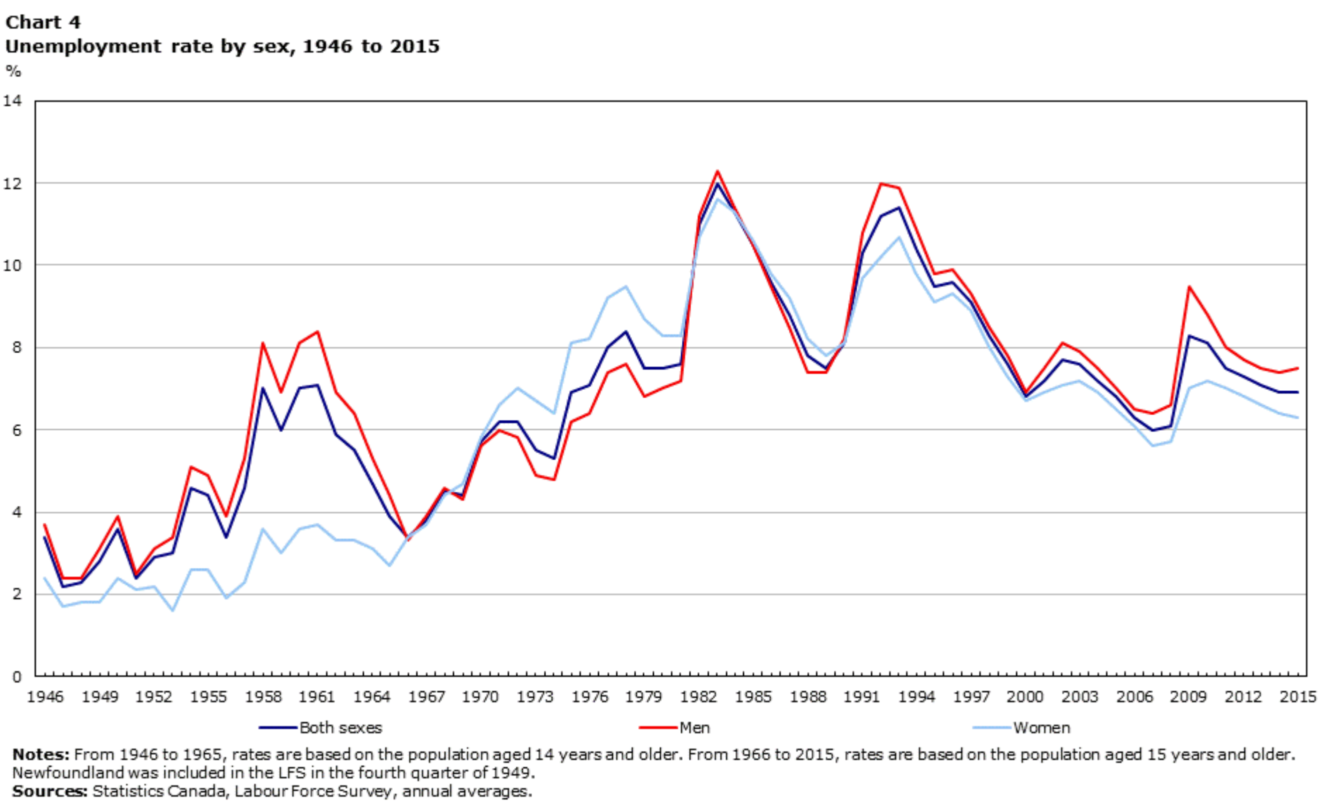


Figure 2.7: Canada's Unemployment Rates 1946-2015 | Statistics Canada

Pick a peak; view a valley.

Pick a peak; view a valley.
Consider what was happening in Canada and/or the world that helps explain one of the peaks or one of the valleys?

Full Employment

To keep the economy going strong, people must spend money on goods and services. A reduction in personal expenditures for things like food, clothing, appliances, automobiles, housing, and medical care could severely reduce GDP and weaken the economy. Because most people earn their spending money by working, an important goal of all economies is making jobs available to everyone who wants one. In principle, full employment occurs when everyone who wants to work has a job. In practice, we say that we have full employment when about 95 percent of those wanting to work are employed.

Price Stability

A third major goal of all economies is maintaining price stability. Price stability occurs when the average of the prices for goods and services either doesn't change or changes very little. Rapidly rising prices are troublesome for both individuals and businesses. For individuals, rising prices mean people have to pay more for the things they need. For businesses, rising prices mean higher costs, and, at least in the short run, businesses might have trouble passing on higher costs to consumers. When the overall price level goes up, we have inflation. The graph in Figure 2.8 shows inflationary trends in the Canadian economy since 1915. The inflation rate in Canada averaged 3.15 percent from 1915 until 2018, reaching an all time high of 21.60 percent in June of 1920 and a record low of -17.80 percent in June of 1921.

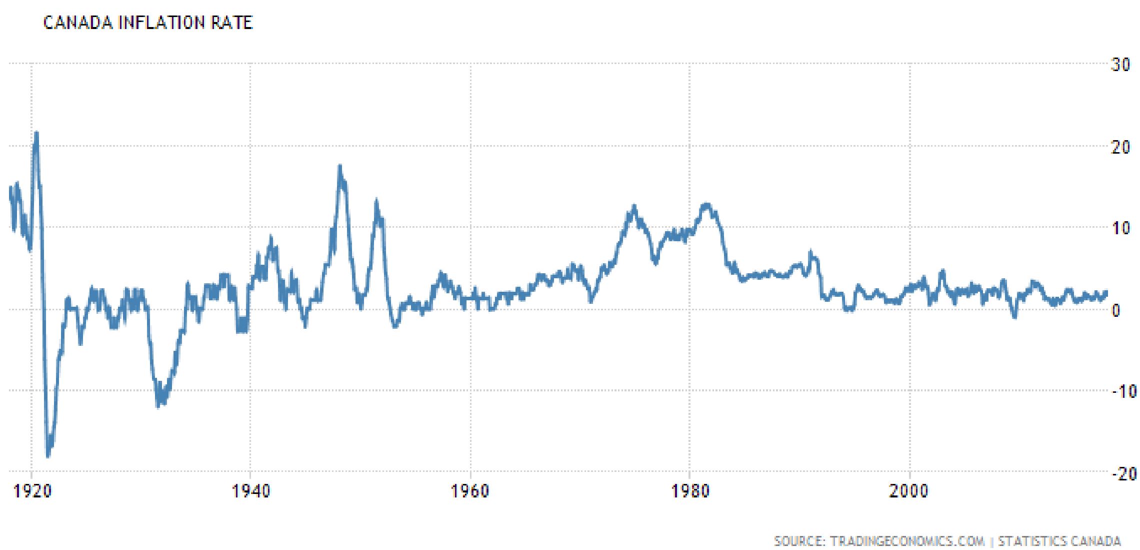


Figure 2.8: Canada's Inflation Rate 1915-2018

When the price level goes down (which rarely happens), we have deflation. A deflationary situation can also be damaging to an economy. When purchasers believe they can expect lower prices in the future, they may defer making purchases, which has the effect of slowing economic growth. Japan experienced a long period of deflation which contributed to economic stagnation in that country from which it is only now beginning to recover.

The Consumer Price Index

The most widely publicized measure of inflation is the consumer price index (CPI), which is reported monthly by Statistics Canada. The CPI measures the rate of inflation by determining price changes of a hypothetical basket of goods, such as food, housing, clothing, medical care, appliances, automobiles, and so forth, bought by a typical household.

The Bank of Canada currently measures prices against the base year of 2002, and the basket for that year is given the value of 100. In 2012 the CPI averaged 121.7, which means that what you could buy for $100 in 2002 cost $121.70 in 2012. The difference registers the effect of inflation. In fact, that's what an inflation rate is—the percentage change in a price index.

> The Bank of Canada created an inflation calculator (https://www.bankofcanada.ca/rates/related/inflation-calculator/). Compare the costs of consumer goods then and now. For example, ask a parent or an older neighbour what they paid for their first car, first house, or first formal wear.

Economic Forecasting

In the previous section, we introduced several measures that economists use to assess the performance of the economy at a given time. By looking at changes in the GDP, for instance, we can see whether the economy is growing. The CPI allows us to gauge inflation. These measures help us understand where the economy stands today. But what if we want to get a sense of where it's headed in the future? To a certain extent, we can forecast future economic trends by analyzing several leading economic indicators.

Economic Indicators

An economic indicator is a statistic that provides valuable information about the economy. There's no shortage of economic indicators, and trying to follow them all would be an overwhelming task. So in this chapter, we'll only discuss the general concept and a few of the key indicators.

Lagging and Leading Indicators

Statistics that report the status of the economy a few months in the past are called lagging economic indicators. One such indicator is average length of unemployment. If unemployed workers have remained out of work for a long time, we may infer that the economy has been slow. Indicators that predict the status of the economy three to twelve months into the future are called leading economic indicators. If such an indicator rises, the economy is more likely to expand in the coming year. If it falls, the economy is more likely to contract.

It is also helpful to look at indicators from various sectors of the economy— labour, manufacturing, and housing. One useful indicator of the outlook for future jobs is the number of new claims for unemployment insurance. This measure tells us how many people recently lost their jobs. If it's rising, it signals trouble ahead because unemployed consumers can't buy as many goods and services as they could if they had paychecks.

To gauge the level of goods to be produced in the future (which will translate into future sales), economists look at a statistic called average weekly manufacturing hours. This measure tells us the average number of hours worked per week by production workers in manufacturing industries. If it's on the rise, the economy will probably improve. For assessing the strength of the housing market, housing starts is often a good indicator. An increase in this statistic—which tells us how many new housing units are being built—indicates that the economy is improving. Why? Because increased building brings money into the economy not only through new home sales but also through sales of furniture and appliances to furnish them.

Since employment is such a key goal in any economy, the Canadian Industry Statistics in collaboration with Statistics Canada tracks total non-farm payroll employment from which the number of net new jobs created can be determined.

Government's Role in Managing the Economy

Monetary Policy

Monetary policy is exercised by the The Bank of Canada, which is empowered to take various actions that decrease or increase the money supply and raise or lower short-term interest rates, making it harder or easier to borrow money. When The Bank of Canada believes that inflation is a problem, it will use contractionary policy to decrease the money supply and raise interest rates. When rates are higher, borrowers have to pay more for the money they borrow, and banks are more selective in making loans. Because money is "tighter"—more expensive to borrow—demand for goods and services will go down, and so will prices. In any case, that's the theory.

The Bank of Canada will typically tighten or decrease the money supply during inflationary periods, making it harder to borrow money.

To counter a recession, The Bank of Canada uses expansionary policy to increase the money supply and reduce interest rates. With lower interest rates, it's cheaper to borrow money, and banks are more willing to lend it. We then say that money is "easy." Attractive interest rates encourage businesses to borrow money to expand production and encourage consumers to buy more goods and services. In theory, both sets of actions will help the economy escape or come out of a recession.

Fiscal Policy

Fiscal policy relies on the government's powers of spending and taxation. Both taxation and government spending can be used to reduce or increase the total supply of money in the economy—the total amount, in other words, that businesses and consumers have to spend. When the country is in a recession, government policy is typically to increase spending, reduce taxes, or both. Such expansionary actions will put more money in the hands of businesses and consumers, encouraging businesses to expand and consumers to buy more goods and services. Expansionary fiscal policy is used to increase government expenditures and/or decrease taxes which causes the government's budget deficit to increase or its budget surplus to decrease. When the economy is experiencing inflation, the opposite policy is adopted: the government will decrease spending or increase taxes, or both. Because such contractionary measures reduce spending by businesses and consumers, prices come down and inflation eases. Contractionary fiscal policy is used to decrease government expenditures and/or increase taxes which causes the government's budget deficit to decrease or its budget surplus to increase.

The National Debt

If, in any given year, the government takes in more money (through taxes) than it spends on goods and services (for things such as defense, transportation, and social services), the result is a budget surplus. If, on the other hand, the government spends more than it takes in, we have a budget deficit (which the government pays off by borrowing through the issuance of Treasury bonds). Historically, deficits have occurred much more often than surpluses; typically, the government spends more than it takes in. Consequently, the Canadian government now has a total national debt of more than $1.154 trillion.

> This number is moving too quickly for the authors to keep the graph current – you can see the current debt at the National Debt Clock (https://www.nationaldebtclocks.org/debtclock/canada)

Key Takeaways / Important Terms and Concepts

1. Economics is the study of the production, distribution, and consumption of goods and services.
2. Economists address these three questions: (1) What goods and services should be produced to meet consumer needs? (2) How should they be produced, and who should produce them? (3) Who should receive goods and services?
3. The answers to these questions depend on a country's economic system. The primary economic systems that exist today are planned and free market systems.
4. In a planned system, such as communism and socialism, the government exerts control over the production and distribution of all or some goods and services.
5. In a free market system, also known as capitalism, business is conducted with only limited government involvement. Competition determines what goods and services are produced, how they are produced, and for whom.
6. In a free market system, buyers and sellers interact in a market to set prices.
7. When the market is characterized by perfect competition, many small companies sell identical products. The price is determined by supply and demand.
8. Supply is the quantity of a product that sellers are willing to sell at various prices. Price also influences the quantity of a product that producers are willing to supply: they'll sell more of a product when prices are high and less when they're low.
9. Demand is the quantity of a product that buyers are willing to purchase at various prices. The quantity of a product that people will buy depends on its price: they'll buy more when the price is low and less when it's high.
10. In a competitive market, the decisions of buyers and sellers interact until the market reaches an equilibrium price—the price at which buyers are willing to buy the same amount that sellers are willing to sell.
11. There are four types of competition in a free market system: perfect competition, monopolistic competition, oligopoly, and monopoly.
12. Under perfect competition, many sellers offer differentiated products— products that differ slightly but serve similar purposes. By making consumers aware of product differences, sellers exert some control over price.
13. In an oligopoly, a few sellers supply a sizable portion of products in the market. They exert some control over price, but because their products are similar, when one company lowers prices, the others follow.
14. In a monopoly, there is only one seller in the market. The market could be a geographical area, such as a city or a regional area, and does not necessarily have to be an entire country. The single seller is able to control prices.
15. Most monopolies fall into one of two categories: natural and legal.
16. Natural monopolies include public utilities, such as electricity and gas suppliers. They inhibit competition, but they're legal because they're important to society.
17. A legal monopoly arises when a company receives a patent giving it exclusive use of an invented product or process for a limited time, generally twenty years. Economies share three goals: growth, high employment, and price stability.
18. Growth. An economy provides people with goods and services, and economists measure its performance by studying the gross domestic product (GDP)—the market value of all goods and services produced by the economy in a given year. If the GDP goes up, the economy is growing; if it goes down, the economy is contracting.

3. Business in a Global Environment

Learning Objectives

By the end of the chapter, you should be able to:

1. Explain why nations and companies participate in international trade and how they measure that trade.
2. Describe the concepts of absolute and comparative advantage.
3. Define importing and exporting.
4. Explain how companies enter the international market through licensing agreements or franchises.
5. Describe how companies reduce costs through contract manufacturing and outsourcing.
6. Explain how cultural, economic, legal, and political differences between countries create challenges to successful business dealings.
7. Discuss the various initiatives designed to reduce international trade barriers and promote free trade.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=62#h5p-11

The Globalization of Business

Do you wear Nike shoes or Timberland boots? Listen to Beyoncé, Pitbull, Twenty One Pilots, or The Neighborhood on Spotify? If you answered yes to either of these questions, you're a global business customer. Both Nike and Timberland manufacture most of their products overseas. Spotify is a Swedish enterprise.

Figure 3.1: Orchard Road by Michael Spencer licensed CC BY | flickr

Take an imaginary walk down Orchard Road, the most fashionable shopping area in Singapore. You'll pass department stores such as Tokyo-based Takashimaya and London's very British Marks & Spencer, both filled with such well-known international labels as Ralph Lauren Polo, Burberry, and Chanel. If you need a break, you can also stop for a latte at Seattle-based Starbucks.

When you're in the Chinese capital of Beijing, don't miss Tiananmen Square. Parked in front of the Great Hall of the People, the seat of Chinese government, are fleets of black Buicks, cars made by General Motors in Flint, Michigan. If you're adventurous enough to find yourself in Faisalabad, a medium-size city in Pakistan, you'll see Hamdard University, located in a refurbished hotel. Step inside its computer labs, and the sensation of being in a faraway place will likely disappear: on the computer screens, you'll recognize the familiar Microsoft flag—the same one emblazoned on screens in Microsoft's hometown of Seattle and just about everywhere else on the planet.

The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's likely that you'll meet and work with individuals from various countries and cultures as customers, suppliers, colleagues, employees, or employers. The bottom line is that the globalization of world commerce has an impact on all of us ~ evidenced in Figure 3.2, The Expanded Circular Flow Model. Therefore, it makes sense to learn more about how globalization works.

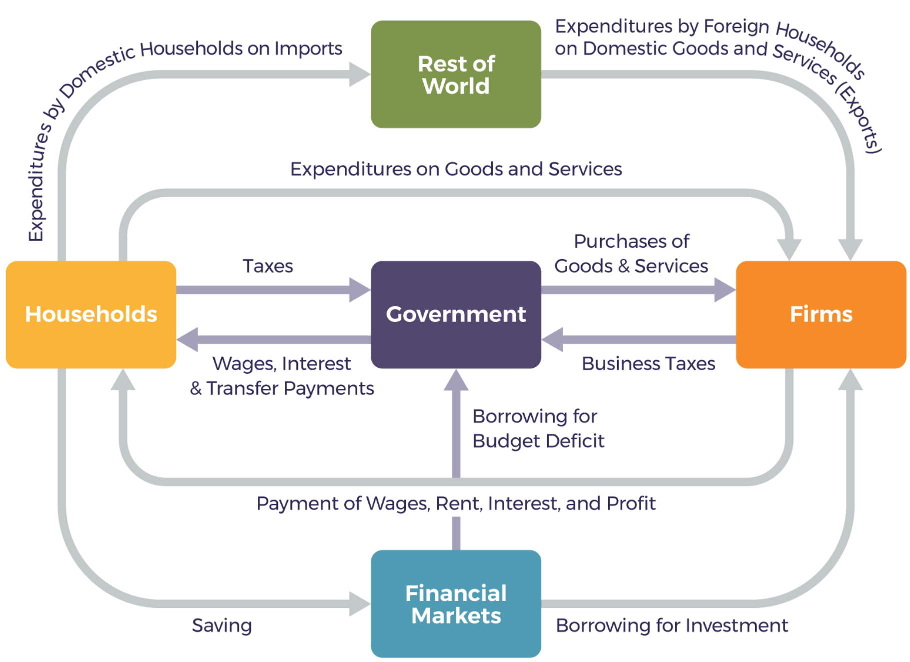


Figure 3.2: Diagram illustrating the reciprocal inputs and outputs from businesses to households.

Never before has business spanned the globe the way it does today and will continue to do in the future. But why is international business important? Why do companies and nations engage in international trade? What strategies do they employ in the global marketplace? How do governments and international agencies promote and regulate international trade? These questions and others will be addressed in this chapter. Let's start by looking at the more specific reasons why companies and nations engage in international trade.

Why Do Nations Trade?

Why does Canada import automobiles, steel, digital phones, and apparel from other countries? Why don't we just make them ourselves? Why do other countries buy wheat, chemicals, machinery, and lumber products from us? Because no national economy produces all the goods and services that its people need. Countries are importers when they buy goods and services from other countries; when they sell products to other nations, they're exporters. (We'll discuss importing and exporting in greater detail later in the chapter.) The monetary value of international trade is enormous. In 2016, the total value of worldwide trade in merchandise and commercial services was $20.208 trillion.[1]

Absolute and Comparative Advantage

To understand why certain countries import or export certain products, you need to realize that every country (or region) can't produce the same products. The cost of labour, the availability of natural resources, and the level of know-how vary greatly around the world. Most economists use the concepts of absolute advantage and comparative advantage to explain why countries import some products and export others.

Absolute Advantage

A nation has an absolute advantage if (1) it's the only source of a particular product or (2) it can make more of a product using fewer resources than other countries. Because of climate and soil conditions, for example, France had an absolute advantage in wine making until its dominance of worldwide wine production was challenged by the growing wine industries in Italy, Spain, the United States, and more recently Canada. Unless an absolute advantage is based on some limited natural resource, it seldom lasts. That's why there are few, if any, examples of absolute advantage in the world today.

Comparative Advantage

How can we predict, for any given country, which products will be made and sold at home, which will be imported, and which will be exported? This question can be answered by looking at the concept of comparative advantage, which exists when a country can produce a product at a lower opportunity cost compared to another nation. But what's an opportunity cost?

Opportunity costs

Since resources are limited, every time you make a choice about how to use them, you are also choosing to forego other options. Economists use the term opportunity cost to indicate what must be given up to obtain something that is desired. A fundamental principle of economics is that every choice has an opportunity cost.

- If you sleep through your economics class (not recommended, by the way), the opportunity cost is the learning you miss.
- If you spend your income on video games, you cannot spend it on movies.
- If you choose to marry one person, you give up the opportunity to marry anyone else.

In short, opportunity cost is all around us.

The idea behind opportunity cost is that the cost of one item is the lost opportunity to do or consume something else; in short, opportunity cost is the value of the next best alternative.

Since people and businesses must choose, they inevitably face trade-offs in which they have to give up things they desire to get other things they desire more.

Opportunity Cost and Individual Decisions

In some cases, recognizing the opportunity cost can alter personal behaviour. Imagine, for example, that you spend $10 on lunch every day at work. You may know perfectly well that bringing a lunch from home would cost only $3 a day, so the opportunity cost of buying lunch at the restaurant is $7 each day (that is, the $10 that buying lunch costs minus the $3 your lunch from home would cost). Ten dollars each day does not seem to be that much. However, if you project what that adds up to in a year—250 workdays a year × $10 per day equals $2 500—it is the cost, perhaps, of a decent vacation. If the opportunity cost were described as "a nice vacation" instead of "$10 a day" you might make different choices.

Opportunity Cost and Societal Decisions

Opportunity cost also comes into play with societal decisions. Universal health care would be nice, but the opportunity cost of such a decision would be less housing, environmental protection, or national defense. These trade-offs also arise with government policies. For example, after the terrorist plane hijackings on September 11, 2001, many proposals, such as the following, were made to improve air travel safety:

- The federal government could provide armed "sky marshals" who would travel inconspicuously with the rest of the passengers. The cost of having a sky marshal on every flight would be roughly $3 billion per year.
- Retrofitting all U.S. planes with reinforced cockpit doors to make it harder for terrorists to take over the plane would have a price tag of $450 million.
- Buying more sophisticated security equipment for airports, like three-dimensional baggage scanners and cameras linked to face-recognition software, would cost another $2 billion.

Lost time can be a significant component of opportunity cost.

However, the single biggest cost of greater airline security does not involve money. It is the opportunity cost of additional waiting time at the airport. According to the United States Department of Transportation, more than 800 million passengers took plane trips in the United States in 2012. Since the 9/11 hijackings, security screening has become more intensive, and consequently, the procedure takes longer than in the past. Say that, on average, each air passenger spends an extra 30 minutes in the airport per trip. Economists commonly place a value on time to convert an opportunity cost in time into a monetary figure. Because many air travelers are relatively highly paid business people, conservative estimates set the average "price of time" for air travelers at $20 per hour. Accordingly, the opportunity cost of delays in airports could be as much as 800 million (passengers) × 0.5 hours × $20/hour—or, $8 billion per year. Clearly, the opportunity costs of waiting time can be just as substantial as costs involving direct spending.

How Do We Measure Trade Between Nations?

To evaluate the nature and consequences of its international trade, a nation looks at two key indicators. We determine a country's balance of trade by subtracting the value of its imports from the value of its exports. If a country sells more products than it buys, it has a favourable balance, called a trade surplus. If it buys more than it sells, it has an unfavourable balance, or a trade deficit.

For many years, Canada has had a trade deficit: we buy far more goods from the rest of the world than we sell overseas. This fact shouldn't be surprising. With high income levels, we not only consume a sizable portion of our own domestically produced goods but enthusiastically buy imported goods. Other countries, such as China and Taiwan, which manufacture high volumes for export, have large trade surpluses because they sell far more goods overseas than they buy.

Managing the National Credit Card

Are trade deficits a bad thing? Not necessarily. They can be positive if a country's economy is strong enough both to keep growing and to generate the jobs and incomes that permit its citizens to buy the best the world has to offer. That was certainly the case in the Canada in the 1990s and early 2000s. Some experts, however, are alarmed by trade deficits. Investment guru Warren Buffet, for example, cautions that no country can continuously sustain large and burgeoning trade deficits. Why not? Because creditor nations will eventually stop taking IOUs from debtor nations, and when that happens, the national spending spree will have to cease. "A nation's credit card," he warns, "charges truly breathtaking amounts. But that card's credit line is not limitless".[2]

By the same token, trade surpluses aren't necessarily good for a nation's consumers. Japan's export-fueled economy produced high economic growth in the 1970s and 1980s. But most domestically made consumer goods were priced at artificially high levels inside Japan itself—so high, in fact, that many Japanese traveled overseas to buy the electronics and other high-quality goods on which Japanese trade was dependent.

CD players and televisions were significantly cheaper in Honolulu or Los Angeles than in Tokyo. How did this situation come about? Though Japan manufactures a variety of goods, many of them are made for export. To secure shares in international markets, Japan prices its exported goods competitively. Inside Japan, because competition is limited, producers can put artificially high prices on Japanese-made goods. Due to a number of factors (high demand for a limited supply of imported goods, high shipping and distribution costs, and other costs incurred by importers in a nation that tends to protect its own industries), imported goods are also expensive.[3]

Balance of Payments

The second key measure of the effectiveness of international trade is balance of payments: the difference, over a period of time, between the total flow of money coming into a country and the total flow of money going out. As in its balance of trade, the biggest factor in a country's balance of payments is the money that flows as a result of imports and exports. But balance of payments includes other cash inflows and outflows, such as cash received from or paid for foreign investment, loans, tourism, military expenditures, and foreign aid. For example, if a Canadian company buys some real estate in a foreign country, that investment counts in the Canadian balance of payments, but not in its balance of trade, which measures only import and export transactions. In the long run, having an unfavorable balance of payments can negatively affect the stability of a country's currency. Canada has experienced unfavorable balances of payments since the turn of the century which has forced the government to cover its debt by borrowing from other countries.[4] The graph in Figure 3.3 provides an example of the balance of payments over time.

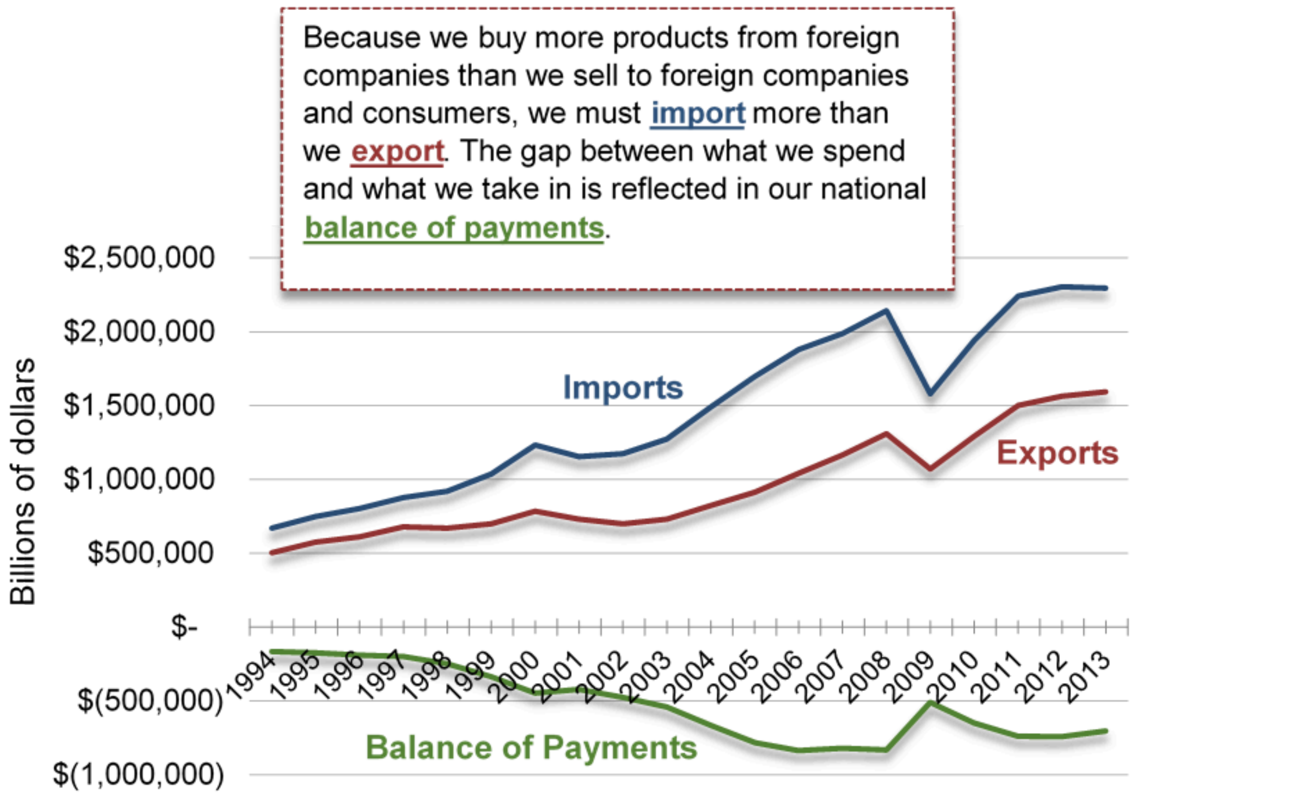


Figure 3.3

Opportunities in International Business

The fact that nations exchange billions of dollars in goods and services each year demonstrates that international trade makes good economic sense. For a company wishing to expand beyond national borders, there are a variety of ways it can get involved in international business. Let's take a closer look at the more popular ones.

Importing and Exporting

Importing (buying products overseas and reselling them in one's own country) and exporting (selling domestic products to foreign customers) are the oldest and most prevalent forms of international trade. For many companies, importing is the primary link to the global market. American food and beverage wholesalers, for instance, import for resale in U.S. supermarkets the bottled waters Evian and Fiji from their sources in the French Alps and the Fiji Islands respectively.[5] Other companies get into the global arena by identifying an international market for their products and becoming exporters. The Chinese, for instance, are fond of fast foods cooked in soybean oil. Because they also have an increasing appetite for meat, they need high-protein soybeans to raise livestock.[6] American farmers now export over $9 billion worth of soybeans to China every year.[7]

Licensing and Franchising

A company that wants to get into an international market quickly while taking only limited financial and legal risks might consider licensing agreements with foreign companies. An international licensing agreement allows a foreign company (the licensee) to sell the products of a producer (the licensor) or to use its intellectual property (such as patents, trademarks, copyrights) in exchange for what is known as royalty fees. Here's how it works: You own a company in the United States that sells coffee-flavored popcorn. You're sure that your product would be a big hit in Japan, but you don't have the resources to set up a factory or sales office in that country. You can't make the popcorn here and ship it to Japan because it would get stale. So you enter into a licensing agreement with a Japanese company that allows your licensee to manufacture coffee-flavored popcorn using your special process and to sell it in Japan under your brand name. In exchange, the Japanese licensee would pay you a royalty fee – perhaps a percentage of each sale or a fixed amount per unit.

Another popular way to expand overseas is to sell franchises. Under an international franchise agreement, a company (the franchiser) grants a foreign company (the franchisee) the right to use its brand name and to sell its products or services. The franchisee is responsible for all operations but agrees to operate according to a business model established by the franchiser. In turn, the franchiser usually provides advertising, training, and new-product assistance. Franchising is a natural form of global expansion for companies that operate domestically according to a franchise model, including restaurant chains, such as McDonald's and Kentucky Fried Chicken, and hotel chains, such as Holiday Inn and Best Western.

Contract Manufacturing and Outsourcing

Because of high domestic labour costs, many U.S. companies manufacture their products in countries where labour costs are lower. This arrangement is called international contract manufacturing, a form of outsourcing. A U.S. company might contract with a local company in a foreign country to manufacture one of its products. It will, however, retain control of product design and development and put its own label on the finished product. Contract manufacturing is quite common in the U.S. apparel business, with most American brands being made in a number of Asian countries, including China, Vietnam, Indonesia, and India.[8]

Thanks to twenty-first-century information technology, non-manufacturing functions can also be outsourced to nations with lower labour costs. Canadian companies are increasingly drawing on a vast supply of relatively inexpensive skilled labour to perform various business services, such as software development, accounting, and claims processing. With a large, well-educated population with English language skills, India has become a centre for software development and customer-call centres. In the case of India, as you can see in Table 3.1, the attraction is not only a large pool of knowledge workers but also significantly lower wages.

Table 3.1: Selected Hourly Wages, Canada and India

Occupation	Canada Wage per Hour (per year)	Indian Wage per Hour (per year)
Accountant	$32 per hour (~$64,000 per year)	$3.15 per hour (~$6,300 per year)
Information Technology Consultant	$35 per hour ($~65,750 per year)	$22.40 per hour (~$44,800 per year)
Cleaner	$15.00 per hour (~$30,000 per year)	$2.10 per hour (~$4,200 per year)

Strategic Alliances and Joint Ventures

What if a company wants to do business in a foreign country but lacks the expertise or resources? Or what if the target nation's government doesn't allow foreign companies to operate within its borders unless it has a local partner? In these cases, a firm might enter into a strategic alliance with a local company or even with the government itself.

A strategic alliance is an agreement between two companies (or a company and a nation) to pool resources in order to achieve business goals that benefit both partners. For example, Viacom (a leading global media company) has a strategic alliance with Beijing Television to produce Chinese-language music and entertainment programming.[9]

An alliance can serve a number of purposes:

- Enhancing marketing efforts
- Building sales and market share
- Improving products
- Reducing production and distribution costs
- Sharing technology

Alliances range in scope from informal cooperative agreements to joint ventures— alliances in which the partners fund a separate entity (perhaps a partnership or a corporation) to manage their joint operation. Magazine publisher Hearst, for example, has joint ventures with companies in several countries. So, young women in Israel can read Cosmo Israel in Hebrew, and Russian women can pick up a Russian-language version of Cosmo that meets their needs. The North American edition serves as a starting point to which nationally appropriate material is added in each different nation. This approach allows Hearst to sell the magazine in more than fifty countries.[10]

Foreign Direct Investment and Subsidiaries

Many of the approaches to global expansion that we've discussed so far allow companies to participate in international markets without investing in foreign plants and facilities. As markets expand, however, a firm might decide to enhance its competitive advantage by making a direct investment in operations conducted in another country. Foreign direct investment (FDI) refers to the formal establishment of business operations on foreign soil—the building of factories, sales offices, and distribution networks to serve local markets in a nation other than the company's home country. On the other hand, offshoring occurs when the facilities set up in the foreign country replace Canadian manufacturing facilities and are used to produce goods that will be sent back to Canada for sale. Shifting production to low-wage countries is often criticized as it results in the loss of jobs for Canadian workers.[11]

FDI is generally the most expensive commitment that a firm can make to an overseas market, and it's typically driven by the size and attractiveness of the target market. For example, German and Japanese automakers, such as BMW, Mercedes, Toyota, and Honda, have made serious commitments to the U.S. market: most of the cars and trucks that they build in plants in the South and Midwest are destined for sale in the United States.

A common form of FDI is the foreign subsidiary: an independent company owned by a foreign firm (called the parent). This approach to going international not only gives the parent company full access to local markets but also exempts it from any laws or regulations that may hamper the activities of foreign firms. The parent company has tight control over the operations of a subsidiary, but while senior managers from the parent company often oversee operations, many managers and employees are citizens of the host country. Not surprisingly, most very large firms have foreign subsidiaries. IBM and Coca-Cola, for example, have both had success in the Japanese market through their foreign subsidiaries (IBM-Japan and Coca-Cola–Japan). FDI goes in the other direction, too, and many companies operating in the United States are in fact subsidiaries of foreign firms. Gerber Products, for example, is a subsidiary of the Swiss company Novartis, while Stop & Shop and Giant Food Stores belong to the Dutch company Royal Ahold. Where does most FDI capital end up? The graph in Figure 3.4 provides an overview of amounts, destinations (high to low income countries), and trends.

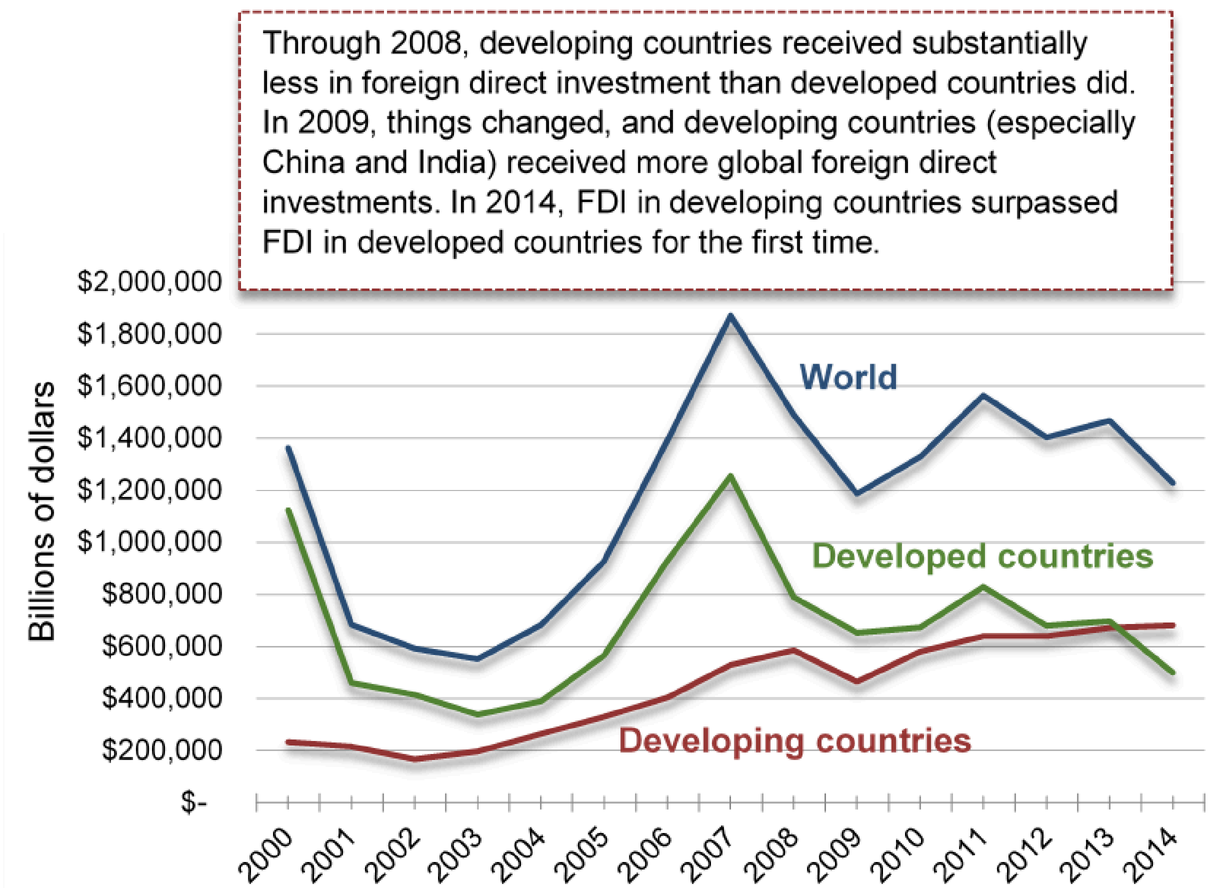


Figure 3.4: Where FDI goes

All these strategies have been employed successfully in global business. But success in international business involves more than finding the best way to reach international markets. Global business is a complex, risky endeavour. Over time, many large companies reach the point of becoming truly multi-national.

Table 3.2: Fortune Top 6 Multinational Firms by Revenue

Company	Industry	Headquarters	Revenue in 2014 (in billions of dollars)	Profits in 2014 (in billions of dollars)
1. Walmart	General Merchandise	USA	$485.9	$13.6
2. State Grid	Utilities	China	$315.2	$9.6
3. Sinopec	Petroleum	China	$267.5	$1.3
4. China National Petroleum	Petroleum	China	$262.6	$1.8
5. Toyota	Automobile	Japan	$254.7	$16.9
6. Volkswagen	Automobile	Germany	$240.3	$5.9

Curious where Apple, Amazon, and other giants landed? For the full Global 500 list from Fortune as well as in-depth background and breakdown, explore: http://fortune.com/global500/list/

Multinational Corporations

A company that operates in many countries is called a multinational corporation (MNC). Fortune magazine's roster of the top 500 MNCs speaks for the growth of non-U.S. businesses. Only one of the top 6 MNCs are headquartered in the United States ~ Wal-Mart (number 1). The others are non-U.S. firms. Also interesting is the difference between company revenues and profits: the list would look quite different arranged by profits instead of revenues!

MNCs often adopt the approach encapsulated in the motto "Think globally, act locally". They often adjust their operations, products, marketing, and distribution to mesh with the environments of the countries in which they operate. Because they understand that a "one-size-fits-all" mentality doesn't make good business sense when they're trying to sell products in different markets, they're willing to accommodate cultural and economic differences. Increasingly, MNCs supplement their mainstream product line with products designed for local markets. Coca-Cola, for example, produces coffee and citrus-juice drinks developed specifically for the Japanese market.[12] When Nokia and Motorola design cell phones, they're often geared to local tastes in color, size, and other features. For example, Nokia introduced a cell phone for the rural Indian consumer that has a dust-resistant keypad, anti-slip grip, and a built-in flashlight.[13] McDonald's provides a vegetarian menu in India, where religious convictions affect the demand for beef and pork.[14] In Germany, McDonald's caters to local tastes by offering beer in some restaurants and a Shrimp Burger in Hong Kong and Japan.[15]

A quick tour of McDonald's around the world

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://pressbooks.nscc.ca/businessfuncdn/?p=62#h5p-12

Likewise, many MNCs have made themselves more sensitive to local market conditions by decentralizing their decision making. While corporate headquarters still maintain a fair amount of control, home-country managers keep a suitable distance by relying on modern telecommunications. Today, fewer managers are dispatched from headquarters; MNCs depend instead on local talent. Not only does decentralized organization speed up and improve decision making, but it also allows an MNC to project the image of a local company. IBM, for instance, has been quite successful in the Japanese market because local customers and suppliers perceive it as a Japanese company. Crucial to this perception is the fact that the vast majority of IBM's Tokyo employees, including top leadership, are Japanese nationals.[16]

Criticism of MNCs

The global reach of MNCs is a source of criticism as well as praise. Critics argue that they often destroy the livelihoods of home-country workers by moving jobs to developing countries where workers are willing to labour under poor conditions and for less pay. They also contend that traditional lifestyles and values are being weakened, and even destroyed, as global brands foster a global culture of American movies; fast food; and cheap, mass-produced consumer products. Still others claim that the demand of MNCs for constant economic growth and cheaper access to natural resources do irreversible damage to the physical environment. All these negative consequences, critics maintain, stem from the abuses of international trade—from the policy of placing profits above people, on a global scale. These views surfaced in violent street demonstrations in Seattle in 1999 and Genoa, Italy, in 2000, and since then, meetings of the International Monetary Fund (IMF) and World Bank have regularly been assailed by protestors.

In Defense of MNCs

Supporters of MNCs respond that huge corporations deliver better, cheaper products for customers everywhere; create jobs; and raise the standard of living in developing countries. They also argue that globalization increases cross-cultural understanding. Anne O. Kruger, first deputy managing director of the IMF, says the following:

"The impact of the faster growth on living standards has been phenomenal. We have observed the increased well-being of a larger percentage of the world's population by a greater increment than ever before in history. Growing incomes give people the ability to spend on things other than basic food and shelter, in particular on things such as education and health. This ability, combined with the sharing among nations of medical and scientific advances, has transformed life in many parts of the developing world.

Infant mortality has declined from 180 per 1,000 births in 1950 to 60 per 1,000 births. Literacy rates have risen from an average of 40 percent in the 1950s to over 70 percent today. World poverty has declined, despite still-high population growth in the developing world."[17]

The Global Business Environment

In the classic movie The Wizard of Oz, a magically misplaced Midwest farm girl takes a moment to survey the bizarre landscape of Oz and then comments to her little dog, "I don't think we're in Kansas anymore, Toto". That sentiment probably echoes the reaction of many businesspeople who find themselves in the midst of international ventures for the first time. The differences between the foreign landscape and the one with which they're familiar are often huge and multifaceted. Some are quite obvious, such as differences in language, currency, and everyday habits (say, using chopsticks instead of silverware). But others are subtle, complex, and sometimes even hidden.

Success in international business means understanding a wide range of cultural, economic, legal, and political differences between countries. Let's look at some of the more important of these differences.

The Cultural Environment

Even when two people from the same country communicate, there's always a possibility of misunderstanding. When people from different countries get together, that possibility increases substantially. Differences in communication styles reflect differences in culture: the system of shared beliefs, values, customs, and behaviors that govern the interactions of members of a society. Cultural differences create challenges to successful international business dealings. Let's look at a few of these challenges.

Language

English is the international language of business. The natives of such European countries as France and Spain certainly take pride in their own languages and cultures, but nevertheless English is the business language of the European community.

Whereas only a few educated Europeans have studied Italian or Norwegian, most have studied English. Similarly, on the South Asian subcontinent, where hundreds of local languages and dialects are spoken, English is the official language. In most corners of the world, English-only speakers—such as most Canadians—have no problem finding competent translators and interpreters. So why is language an issue for English speakers doing business in the global marketplace? In many countries, only members of the educated classes speak English. The larger population—which is usually the market you want to tap—speaks the local tongue. Advertising messages and sales appeals must take this fact into account. More than one English translation of an advertising slogan has resulted in a humorous (and perhaps serious) blunder.

Lost in translation

- In Belgium, the translation of the slogan of an American auto-body company, *Body by Fisher,* came out as *Corpse by Fisher*.
- Translated into German, the slogan, *Come Alive with Pepsi* became *Come Out of the Grave with Pepsi*.
- A U.S. computer company in Indonesia translated "software" as "underwear".
- A German chocolate product called "Zit" didn't sell well in the U.S.
- An English-speaking car wash company in Francophone Quebec advertised itself as a "lavement d'auto" or "car enema" instead of the correct "lavage d'auto.
- In the 1970s, General Motors' Chevy Nova didn't get on the road in Puerto Rico, in part because "nova" in Spanish means "it doesn't go".

Furthermore, relying on translators and interpreters puts you as an international businessperson at a disadvantage. You're privy only to interpretations of the messages that you're getting, and this handicap can result in a real competitive problem. Maybe you'll misread the subtler intentions of the person with whom you're trying to conduct business. The best way to combat this problem is to study foreign languages. Most people appreciate some effort to communicate in their local language, even on the most basic level. They even appreciate mistakes you make resulting from a desire to demonstrate your genuine interest in the language of your counterparts in foreign countries. The same principle goes doubly when you're introducing yourself to non- English speakers in Canada. Few things work faster to encourage a friendly atmosphere than a native speaker's willingness to greet a foreign guest in the guest's native language.

Time and Sociability

North Americans take for granted many of the cultural aspects of our business practices. Most of our meetings, for instance, focus on business issues, and we tend to start and end our meetings on schedule. These habits stem from a broader cultural preference: we don't like to waste time. (It was an American, Benjamin Franklin, who coined the phrase "Time is money.") This preference, however, is by no means universal. The expectation that meetings will start on time and adhere to precise agendas is common in parts of Europe (especially the Germanic countries), as well as in Canada, but elsewhere—say, in Latin America and the Middle East—people are often late to meetings.

High- and Low-Context Cultures

Likewise, don't expect businesspeople from these regions—or businesspeople from most of Mediterranean Europe, for that matter—to "get down to business" as soon as a meeting has started. They'll probably ask about your health and that of your family, inquire whether you're enjoying your visit to their country, suggest local foods, and generally appear to be avoiding serious discussion at all costs. For Canadians, such topics are conducive to nothing but idle chitchat, but in certain cultures, getting started this way is a matter of simple politeness and hospitality.

Intercultural Communication

Different cultures have different communication styles—a fact that can take some getting used to. For example, degrees of animation in expression can vary from culture to culture. Southern Europeans and Middle Easterners are quite animated, favoring expressive body language along with hand gestures and raised voices. Northern Europeans are far more reserved. The English, for example, are famous for their understated style and the Germans for their formality in most business settings. In addition, the distance at which one feels comfortable when talking with someone varies by culture. People from the Middle East like to converse from a distance of a foot or less, while North Americans prefer more personal space.

Finally, while people in some cultures prefer to deliver direct, clear messages, others use language that's subtler or more indirect. North Americans and most Northern Europeans fall into the former category and many Asians into the latter. But even within these categories, there are differences. Though typically polite, Chinese and Koreans are extremely direct in expression, while Japanese are indirect: They use vague language and avoid saying "no" even if they do not intend to do what you ask. They worry that turning someone down will result in their "losing face", i.e., an embarrassment or loss of credibility, and so they avoid doing this in public.

In summary, learn about a country's culture and use your knowledge to help improve the quality of your business dealings. Learn to value the subtle differences among cultures, but don't allow cultural stereotypes to dictate how you interact with people from any culture. Treat each person as an individual and spend time getting to know what he or she is about.

The Economic Environment

If you plan to do business in a foreign country, you need to know its level of economic development. You also should be aware of factors influencing the value of its currency and the impact that changes in that value will have on your profits.

Economic Development

If you don't understand a nation's level of economic development, you'll have trouble answering some basic questions, such as: Will consumers in this country be able to afford the product I want to sell? Will it be possible to make a reasonable profit? A country's level of economic development can be evaluated by estimating the annual income earned per citizen. The World Bank, which lends money for improvements in underdeveloped nations, divides countries into four income categories:

World Bank Country and Lending Groups (by Gross National Income per Capita 2015)[18]

- High income—$12,736 or higher (United States, Germany, Japan, Canada)
- Upper-middle income—$4,126 to $12,735 (China, South Africa, Mexico)
- Lower-middle income—$1,046 to $4,125 (Kenya, Philippines, India)
- Low income—$1,045 or less (Afghanistan, South Sudan, Haiti)

Note that that even though a country has a low annual income per citizen, it can still be an attractive place for doing business. India, for example, is a lower-middle-income country, yet it has a population of a billion, and a segment of that population is well educated—an appealing feature for many business initiatives.

The long-term goal of many countries is to move up the economic development ladder. Some factors conducive to economic growth include a reliable banking system, a strong stock market, and government policies to encourage investment and competition while discouraging corruption. It's also important that a country have a strong infrastructure—its systems of communications (telephone, Internet, television, newspapers), transportation (roads, railways, airports), energy (gas and electricity, power plants), and social facilities (schools, hospitals). These basic systems will help countries attract foreign investors, which can be crucial to economic development.

Currency Valuations and Exchange Rates

If every nation used the same currency, international trade and travel would be a lot easier. Of course, this is not the case. There are around 175 currencies in the world: Some you've heard of, such as the British pound; others are likely unknown to you, such as the manat, the official currency of Azerbaijan. If you were in Azerbaijan you would exchange your Canadian dollars for Azerbaijan manats. The day's foreign exchange rate will tell you how much one currency is worth relative to another currency and so determine how many manats you will receive. If you have traveled abroad, you already have personal experience with the impact of exchange rate movements.

The Legal and Regulatory Environment

One of the more difficult aspects of doing business globally is dealing with vast differences in legal and regulatory environments. Canada, for example, has an established set of laws and regulations that provide direction to businesses operating within its borders. But because there is no global legal system, key areas of business law—for example, contract provisions and copyright protection—can be treated in different ways in different countries. Companies doing international business often face many inconsistent laws and regulations. To navigate this sea of confusion, Canadian business people must know and follow both Canadian laws and regulations and those of nations in which they operate.

Business history is filled with stories about North American companies that have stumbled in trying to comply with foreign laws and regulations. Coca-Cola, for example, ran afoul of Italian law when it printed its ingredients list on the bottle cap rather than on the bottle itself. Italian courts ruled that the labelling was inadequate because most people throw the cap away.[19]

One approach to dealing with local laws and regulations is hiring lawyers from the host country who can provide advice on legal issues. Another is working with local business people who have experience in complying with regulations and overcoming bureaucratic obstacles.

Foreign Corrupt Practices Act

One Canadian law that creates unique challenges for Canadian firms operating overseas is the Corruption of Foreign Public Officials Act (CFPOA), which prohibits the distribution of bribes and other favors in the conduct of business. Despite the practice being illegal in Canada, such tactics as kickbacks and bribes are business-as-usual in many nations. According to some experts, Canadian business people are at a competitive disadvantage if they're prohibited from giving bribes or undercover payments to foreign officials or business people who expect them. In theory, because the Corruption of Foreign Public Officials Act warns foreigners that Canadians can't give bribes, they'll eventually stop expecting them.

Where are business people most likely and least likely to encounter bribe requests and related forms of corruption? Transparency International, an independent German-based organization, annually rates nations according to "perceived corruption," (see Table 3.3) which it defines as "the abuse of entrusted power for private gain."[20]

Transparency International reports on corruption and publishes an annual Corruption Perceptions Index that rates the world's countries. A score of 100 would be perfect (corruption free) and anything below 30 establishes that corruption is rampant.

Table 3.3

Rank	Country	CPI Score
1	New Zealand	89
2	Denmark	88
3	Finland	85
3	Norway	85
3	Switzerland	85
4	Singapore	84
4	Sweden	84
5	Canada	82
176	Yemen	16
176	Sudan	16
177	Afghanistan	15
178	Syria	14
179	South Sudan	12
180	Somalia	9

Trade Controls

The debate about the extent to which countries should control the flow of foreign goods and investments across their borders is as old as international trade itself. Governments continue to control trade. To better understand how and why, let's examine a hypothetical case. Suppose you're in charge of a small country in which people do two things—grow food and make clothes. Because the quality of both products is high and the prices are reasonable, your consumers are happy to buy locally made food and clothes. But one day, a farmer from a nearby country crosses your border with several wagonloads of wheat to sell. On the same day, a foreign clothes maker arrives with a large shipment of clothes. These two entrepreneurs want to sell food and clothes in your country at prices below those that local consumers now pay for domestically made food and clothes. At first, this seems like a good deal for your consumers: they won't have to pay as much for food and clothes. But then you remember all the people in your country who grow food and make clothes. If no one buys their goods (because the imported goods are cheaper), what will happen to their livelihoods? And if many people become unemployed, what will happen to your national economy? That's when you decide to protect your farmers and clothes makers by setting up trade rules. Maybe you'll increase the prices of imported goods by adding a tax to them; you might even make the tax so high that they're more expensive than your homemade goods. Or perhaps you'll help your farmers grow food more cheaply by giving them financial help to defray their costs. The government payments that you give to the farmers to help offset some of their costs of production are called subsidies. These subsidies will allow the farmers to lower the price of their goods to a point below that of imported competitors' goods. What's even better is that the lower costs will allow the farmers to export their own goods at attractive, competitive prices.

Canada has a long history of subsidizing farmers. Subsidy programs guarantee farmers (including large corporate farms) a certain price for their crops, regardless of the market price. This guarantee ensures stable income in the farming community but can have a negative impact on the world economy. How? Critics argue that in allowing Canadian farmers to export crops at artificially low prices,Canadian agricultural subsidies permit them to compete unfairly with farmers in developing countries. A reverse situation occurs in the steel industry, in which a number of countries—China, Japan, Russia, Germany, and Brazil—subsidize domestic producers.

In 2017, trade with the United States accounted for $411 billion, 75% of Canada's exports, but Canada only imported $370 billion from the U.S., achieving a positive trade balance of more than $40 billion. U.S. trade unions charge that trade subsidy practices gives an unfair advantage to foreign producers and hurts American industries, which can't compete on price with subsidized imports.

Whether they push up the price of imports or push down the price of local goods, such initiatives will help locally produced goods compete more favorably with foreign goods. Both strategies are forms of trade controls—policies that restrict free trade. Because they protect domestic industries by reducing foreign competition, the use of such controls is often called protectionism. Though there's considerable debate over the pros and cons of this practice, all countries engage in it to some extent. Before debating the issue, however, let's learn about the more common types of trade restrictions: tariffs, quotas, and, embargoes.

Tariffs

Tariffs are taxes on imports. Because they raise the price of the foreign-made goods, they make them less competitive. Tariffs are also used to raise revenue for a government. Donald Trump, President of The United States, for example, announced in March of 2018 that the U.S. would increase tariffs on imported steel products from 10% to 25% as a means of enhancing the American steel industry and protecting U.S steel manufacturers.

Quotas

A quota imposes limits on the quantity of a good that can be imported over a period of time. Quotas are used to protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms. Canadian import quotas take two forms. An absolute quota fixes an upper limit on the amount of a good that can be imported during the given period. A tariff-rate quota permits the import of a specified quantity and then adds a high import tax once the limit is reached.

Sometimes quotas protect one group at the expense of another. To protect sugar beet and sugar cane growers, for instance, the United States imposes a tariff-rate quota on the importation of sugar—a policy that has driven up the cost of sugar to two to three times world prices.[22] These artificially high prices push up costs for American candy makers, some of whom have moved their operations elsewhere, taking high-paying manufacturing jobs with them. Life Savers, for example, were made in the United States for ninety years but are now produced in Canada, where the company saves $9 million annually on the cost of sugar.[23]

An extreme form of quota is the embargo, which, for economic or political reasons, bans the import or export of certain goods to or from a specific country.

Dumping

A common political rationale for establishing tariffs and quotas is the need to combat dumping: the practice of selling exported goods below the price that producers would normally charge in their home markets (and often below the cost of producing the goods). Usually, nations resort to this practice to gain entry and market share in foreign markets, but it can also be used to sell off surplus or obsolete goods. Dumping creates unfair competition for domestic industries, and governments are justifiably concerned when they suspect foreign countries of dumping products on their markets. They often retaliate by imposing punitive tariffs that drive up the price of the imported goods.

The Pros and Cons of Trade Controls

Opinions vary on government involvement in international trade. Proponents of controls contend that there are a number of legitimate reasons why countries engage in protectionism. Sometimes they restrict trade to protect specific industries and their workers from foreign competition—agriculture, for example, or steel making. At other times, they restrict imports to give new or struggling industries a chance to get established. Finally, some countries use protectionism to shield industries that are vital to their national defense, such as shipbuilding and military hardware.

Despite valid arguments made by supporters of trade controls, most experts believe that such restrictions as tariffs and quotas—as well as practices that don't promote level playing fields, such as subsidies and dumping—are detrimental to the world economy. Without impediments to trade, countries can compete freely. Each nation can focus on what it does best and bring its goods to a fair and open world market. When this happens, the world will prosper, or so the argument goes. International trade is certainly heading in the direction of unrestricted markets.

Reducing International Trade Barriers

A number of organizations work to ease barriers to trade, and more countries are joining together to promote trade and mutual economic benefits. Let's look at some of these important initiatives.

Trade Agreements and Organizations

Free trade is encouraged by a number of agreements and organizations set up to monitor trade policies. The two most important are the General Agreement on Tariffs and Trade and the World Trade Organization.

General Agreement on Tariffs and Trade

After the Great Depression and World War II, most countries focused on protecting home industries, so international trade was hindered by rigid trade restrictions. To rectify this situation, twenty-three nations joined together in 1947 and signed the General Agreement on Tariffs and Trade (GATT), which encouraged free trade by regulating and reducing tariffs and by providing a forum for resolving trade disputes.

The highly successful initiative achieved substantial reductions in tariffs and quotas, and in 1995 its members founded the World Trade Organization to continue the work of GATT in overseeing global trade.

World Trade Organization

Based in Geneva, Switzerland, with nearly 150 members, the World Trade Organization (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes. It is empowered, for instance, to determine whether a member nation's trade policies have violated the organization's rules, and it can direct "guilty" countries to remove disputed barriers (though it has no legal power to force any country to do anything it doesn't want to do). If the guilty party refuses to comply, the WTO may authorize the plaintiff nation to erect trade barriers of its own, generally in the form of tariffs.

Affected members aren't always happy with WTO actions. In 2002, for example, President George Bush's administration imposed a three-year tariff on imported steel. In ruling against this tariff, the WTO allowed the aggrieved nations to impose counter-tariffs on some politically sensitive American products, such as Florida oranges, Texas grapefruits and computers, and Wisconsin cheese. Reluctantly, the administration lifted its tariff on steel.[24]

Financial Support for Emerging Economies: The IMF and the World Bank

A key to helping developing countries become active participants in the global marketplace is providing financial assistance. Offering monetary assistance to some of the poorest nations in the world is the shared goal of two organizations: the International Monetary Fund and the World Bank. These organizations, to which most countries belong, were established in 1944 to accomplish different but complementary purposes.

The International Monetary Fund

The International Monetary Fund (IMF) loans money to countries with troubled economies, such as Mexico in the 1980s and mid-1990s and Russia and Argentina in the late 1990s. There are, however, strings attached to IMF loans: in exchange for relief in times of financial crisis, borrower countries must institute sometimes painful financial and economic reforms. In the 1980s, for example, Mexico received financial relief from the IMF on the condition that it privatize and deregulate certain industries and liberalize trade policies. The government was also required to cut back expenditures for such services as education, health care, and workers' benefits.[25]

The World Bank

The World Bank is an important source of economic assistance for poor and developing countries. With backing from wealthy donor countries (such as Canada, the United States, Japan, Germany, and United Kingdom), the World Bank has committed $42.5 billion in loans, grants, and guarantees to some of the world's poorest nations.[26] Loans are made to help countries improve the lives of the poor through community-support programs designed to provide health, nutrition, education, infrastructure, and other social services.

Trading Blocs: NAFTA/ USMCA and the European Union

So far, our discussion has suggested that global trade would be strengthened if there were no restrictions on it—if countries didn't put up barriers to trade or perform special favors for domestic industries. The complete absence of barriers is an ideal state of affairs that we haven't yet attained. In the meantime, economists and policymakers tend to focus on a more practical question: Can we achieve the goal of free trade on the regional level? To an extent, the answer is yes. In certain parts of the world, groups of countries have joined together to allow goods and services to flow without restrictions across their mutual borders. Such groups are called trading blocs. Let's examine two of the most powerful trading blocs—NAFTA and the European Union.

North American Free Trade

The North American Free Trade Association (NAFTA) is the original agreement among the governments of the United States, Canada, and Mexico to open their borders to unrestricted trade. NAFTA was replaced by the USMCA (United States, Mexico, Canada Agreement) in 2020. The effect of this agreement is that three very different economies are combined into one economic zone with almost no trade barriers. From the northern tip of Canada to the southern tip of Mexico, each country benefits from the comparative advantages of its partners: each nation is free to produce what it does best and to trade its goods and services without restrictions.

When the original NAFTA agreement was ratified in 1994, it had no shortage of skeptics. Many people feared, for example, that without tariffs on Mexican goods, more U.S. and Canadian manufacturing jobs would be lost to Mexico, where labour is cheaper. Almost two decades later, most such fears have not been realized, and, by and large, NAFTA has been a success. USMCA has improved the agreement from many perspectives. Others argue that UMCA has many drawbacks for Canada including introducing increased competition for the dairy sector.

Since free trade, the value of trade between Canada and Mexico has grown substantially, and Canada and Mexico are now the United States' top trading partners.

The European Union

The forty-plus countries of Europe have long shown an interest in integrating their economies. The first organized effort to integrate a segment of Europe's economic entities began in the late 1950s, when six countries joined together to form the European Economic Community (EEC). Over the next four decades, membership grew, and in the late 1990s, the EEC became the European Union. Today, the European Union (EU) is a group of twenty-seven countries that have eliminated trade barriers among themselves (see the map in Figure 3.5).

At first glance, the EU looks similar to NAFTA. Both, for instance, allow unrestricted trade among member nations. But the provisions of the EU go beyond those of NAFTA in several important ways. Most importantly, the EU is more than a trading organization: it also enhances political and social cooperation and binds its members into a single entity with authority to require them to follow common rules and regulations. It is much like a federation of states with a weak central government, with the effect not only of eliminating internal barriers but also of enforcing common tariffs on trade from outside the EU. In addition, while NAFTA allows goods and services as well as capital to pass between borders, the EU also allows people to come and go freely: if you possess an EU passport, you can work in any EU nation.

In 2020 The United Kingdom (UK) left the European Union (EU) and has begun to unravel the tight trade relationships between the UK and other EU member states. This process is ongoing.

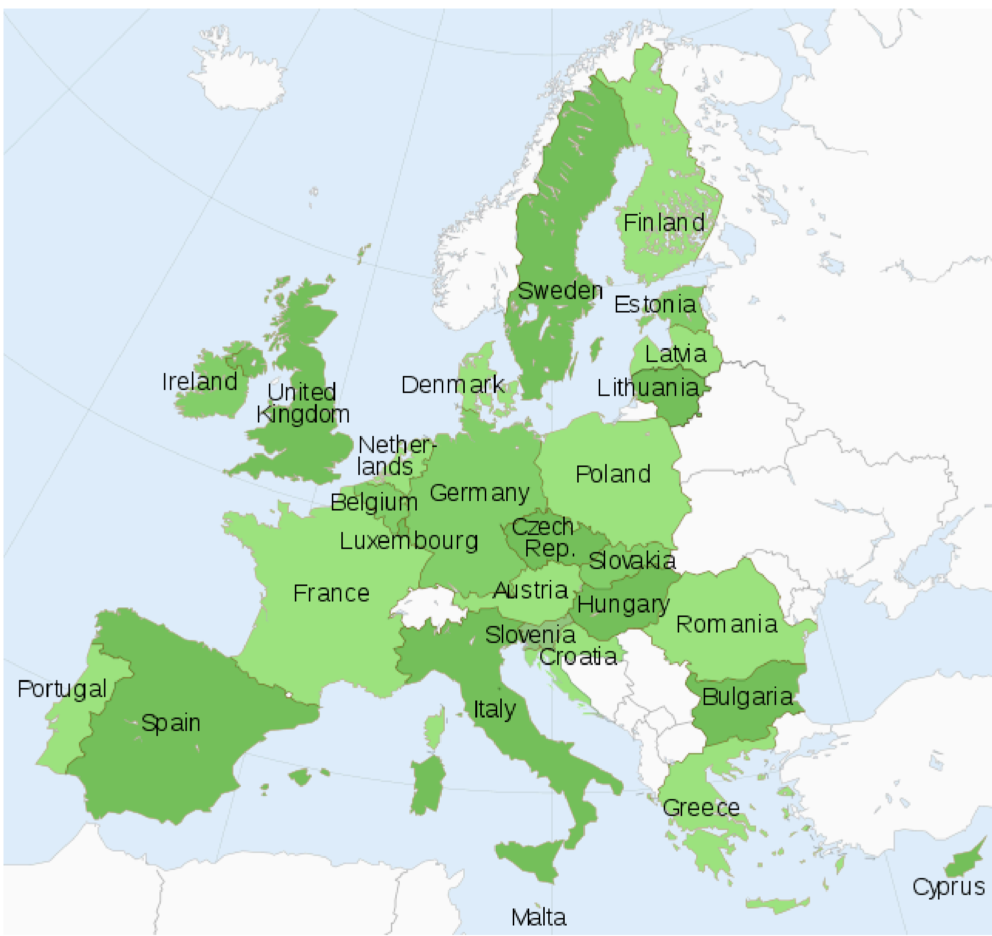


Figure 3.5: Member states of the European Union from https://en.wikipedia.org

The Euro

A key step toward unification occurred in 1999, when most (but not all) EU members agreed to abandon their own currencies and adopt a joint currency. The actual conversion occurred in 2002, when a common currency called the euro replaced the separate currencies of participating EU countries. The common currency facilitates trade and finance because exchange-rate differences no longer complicate transactions.[27]

Its proponents argued that the EU would not only unite economically and politically distinct countries but also create an economic power that could compete against the dominant players in the global marketplace. Individually, each European country has limited economic power, but as a group, they could be an economic superpower.[28] Over time, the value of the euro has been questioned. Many of the "euro" countries (Spain, Italy, Greece, Portugal, and Ireland in particular) have been financially irresponsible, piling up huge debts and experiencing high unemployment and problems in the housing market. But because these troubled countries share a common currency with the other "euro countries", they are less able to correct their economic woes.[29] Many economists fear that the financial crisis precipitated by these financially irresponsible countries threaten the very survival of the euro.[30] The UK voted to leave the EU in 2016, although this does not necessarily mean the UK will indeed leave the EU, as that will ultimately be finalized in 2019, the UK has performed well since the vote to leave the EU.

Only time will tell whether the trend toward regional trade agreements is good for the world economy. Clearly, they're beneficial to their respective participants; for one thing, they get preferential treatment from other members. But certain questions still need to be answered more fully. Are regional agreements, for example, moving the world closer to free trade on a global scale—toward a marketplace in which goods and services can be traded anywhere without barriers?

Key Takeaways / Important Terms and Concepts

1. Nations trade because they don't produce all the products that their inhabitants need.
2. The cost of labour, the availability of natural resources, and the level of know-how vary greatly around the world, so not every country has the same resources or is good at producing the same products.
3. To explain how countries decide what products to import and export, economists use the concepts of absolute and comparative advantage: A nation has an absolute advantage if it's the only source of a particular product or can make more of a product with the same amount of or fewer resources than other countries. A comparative advantage exists when a country can produce a product at a lower opportunity cost than other nations.
4. We determine a country's balance of trade by subtracting the value of its imports from the value of its exports. If a country sells more products than it buys, it has a favorable balance, called a trade surplus. If it buys more than it sells, it has an unfavorable balance, or a trade deficit.
5. The balance of payments is the difference, over a period of time, between the total flow coming into a country and the total flow going out. The biggest factor in a country's balance of payments is the money that comes in and goes out as a result of exports and imports.
6. A company that operates in many countries is called a multinational corporation (MNC).

7. For a company in Canada wishing to expand beyond national borders, there are a variety of ways to get involved in international business:
    - Importing involves purchasing products from other countries and reselling them in one's own.
    - Exporting entails selling products to foreign customers
    - Under a franchise agreement, a company grants a foreign company the right to use its brand name and sell its products.
    - A licensing agreement allows a foreign company to sell a company's products or use its intellectual property in exchange for royalty fees.
    - Through international contract manufacturing, or outsourcing, a company has its products manufactured or services provided in other countries.
    - A joint venture is a type of strategic alliance in which a separate entity funded by the participating companies is formed.
    - Foreign direct investment (FDI) refers to the formal establishment of business operations on foreign soil.
    - A common form of FDI is the foreign subsidiary, an independent company owned by a foreign firm.
8. Success in international business requires an understanding an assortment of cultural, economic, and legal/regulatory differences between countries. Cultural challenges stem from differences in language, concepts of time and sociability, and communication styles.
9. Because they protect domestic industries by reducing foreign competition, the use of controls to restrict free trade is often called protectionism.
    - Tariffs are taxes on imports. Because they raise the price of the foreign-made goods, they make them less competitive.
    - Quotas are restrictions on imports that impose a limit on the quantity of a good that can be imported over a period of time. They're used to protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms.
    - An embargo is a quota that, for economic or political reasons, bans the import or export of certain goods to or from a specific country.
10. A common rationale for tariffs and quotas is the need to combat dumping—the practice of selling exported goods below the price that producers would normally charge in their home markets (and often below the costs of producing the goods).
11. Free trade is encouraged by a number of agreements and organizations set up to monitor trade policies.
    - The General Agreement on Tariffs and Trade (GATT) regulates free trade, reduces tariffs and provides a forum for resolving trade disputes.
    - The World Trade Organization (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes.
12. The International Monetary Fund (IMF) and the World Bank both provide monetary assistance to the world's poorest countries.
13. In certain parts of the world, groups of countries have formed trading blocs to allow goods and services to flow without restrictions across their mutual borders.
    - Examples include the USMCA (United States, Canada, and Mexico) and the European Union (EU), a group of twenty-seven countries that have eliminated trade barriers among themselves.

Some Recent World Events

The previous section of this text outlined some recent changes in the global economic environment. To gain a better understanding of this ever changing landscape and (reasonably) current events, watch the videos below.

Learning Activities

Protests in Hong Kong & Brexit

1. Watch the Video: Hong Kong's huge protests explained.

A YouTube element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=62

2. Read the linked article on Nation Master: Economy Stats: compare key data on Canada & China (https://www.nationmaster.com/country-info/compare/Canada/China/Economy)

3. Watch the CNN video: Here is what you need to know about Brexit.

(https://www.cnn.com/videos/world/2019/01/12/brexit-questions-answered-lon-orig.cnn)

4. Read the linked article on Nation Master: Economy Stats: compare key data on Canada & United Kingdom (https://www.nationmaster.com/country-info/compare/Canada/United-Kingdom/Economy)

4. Forms of Business Ownership

Learning Objectives

By the end of the chapter, you should be able to:

1. Identify the questions to ask in choosing the appropriate form of ownership for a business.
2. Describe the sole proprietorship and partnership forms of organization, and specify the advantages and disadvantages.
3. Identify the different types of partnerships, and explain the importance of a partnership agreement.
4. Explain how corporations are formed and how they operate.
5. Discuss the advantages and disadvantages of the corporate form of ownership.
6. Examine special types of business ownership, including limited liability companies, cooperatives, and not-for-profit corporations.
7. Define mergers and acquisitions, and explain why companies are motivated to merge or acquire other companies.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=68#h5p-13

The Ice Cream Men

Who would have thought it? Two ex-hippies with strong interests in social activism would end up starting one of the best-known ice cream companies in the country—Ben & Jerry's. Perhaps it was meant to be. Ben Cohen (the "Ben" of Ben & Jerry's) always had a fascination with ice cream. As a child, he made his own mixtures by smashing his favorite cookies and candies into his ice cream.

Figure 4.1: Ben Cohen and Jerry Greenfield from https://commons.wikimedia.org licensed CC BY SA

But it wasn't until his senior year in high school that he became an official "ice cream man," happily driving his truck through neighborhoods filled with kids eager to buy his ice cream pops. After high school, Ben tried college but it wasn't for him. He attended Colgate University for a year and a half before he dropped out to return to his real love: being an ice cream man. He tried college again—this time at Skidmore, where he studied pottery and jewelry making—but, in spite of his selection of courses, still didn't like it.

In the meantime, Jerry Greenfield (the "Jerry" of Ben & Jerry's) was following a similar path. He majored in pre-med at Oberlin College in the hopes of one day becoming a doctor. But he had to give up on this goal when he was not accepted into medical school. On a positive note, though, his college education steered him into a more lucrative field: the world of ice cream making. He got his first peek at the ice cream industry when he worked as a scooper in the student cafeteria at Oberlin. So, fourteen years after they first met on the junior high school track team, Ben and Jerry reunited and decided to go into ice cream making big time. They moved to Burlington, Vermont—a college town in need of an ice cream parlor—and completed a $5 correspondence course from Penn State on making ice cream. After getting an A in the course—not surprising, given that the tests were open book—they took the plunge: with their life savings of $8,000 and $4,000 of borrowed funds they set up an ice cream shop in a made-over gas station on a busy street corner in Burlington.[1] The next big decision was which form of business ownership was best for them. This chapter introduces you to their options.

The Canadian Landscape

Innovation, Science and Economic Development Canada (ISED) defines a business based upon the number of paid employees. For this reason, self-employed and "indeterminate" businesses are generally not included in the present publication as they do not have paid employees.

Accordingly, this publication defines an SME (small-to-medium enterprise) as a business establishment with 1–499 paid employees, more specifically:

- A small business has 1 to 99 paid employees.
- A medium-sized business has 100 to 499 paid employees.
- A large business has 500 or more paid employees.

ISED also categorizes businesses with 1-4 employees as micro-enterprises.

According to Industry Canada, "As of December 2015, there were 1.17 million employer businesses in Canada, as shown in Table 4.1. Of these, 1.14 million (97.9 percent) businesses were small businesses, 21,415 (1.8 percent) were medium-sized businesses and 2,933 (0.3 percent) were large enterprises." [2]

Total Number of Employer Businesses by Size and Number of Small and Medium-Sized Businesses per 1,000 Provincial Population					
Provinces/ Territories	Employer Businesses				Number of SMEs per 1,000 Population (aged 15+ years)
	Small (1–99)	Medium (100–499)	Large (500+)	Total	
Newfoundland and Labrador	17,174	307	45	17,526	39.1
Prince Edward Island	5,838	83	14	5,935	48.7
Nova Scotia	29,298	556	68	29,922	37.3
New Brunswick	25,002	443	64	25,509	40.0
Quebec	235,075	4,301	590	239,966	34.7
Ontario	407,175	8,437	1,189	416,801	36.3
Manitoba	37,776	829	107	38,712	37.3
Saskatchewan	40,453	644	88	41,185	45.5
Alberta	165,792	3,076	437	169,305	50.0
British Columbia	176,014	2,623	329	178,966	45.2
Yukon	1,723	34	0	1,757	57.3
Northwest Territories	1,606	51	1	1,658	48.5
Nunavut	704	31	1	736	29.6
Canada	1,143,630	21,415	2,933	1,167,978	39.2
Percentage	97.9	1.8	0.3	100.0	
Source: Statistics Canada, Business Register, December 2015					

Table 4.1

Factors to Consider

If you're starting a new business, you have to decide which legal form of ownership is best for you and your business. Do you want to own the business yourself and operate as a sole proprietorship? Or, do you want to share ownership, operating as a partnership or a corporation? Before we discuss the pros and cons of these three types of ownership, let's address some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business.

1. In setting up your business, do you want to minimize the costs of getting started? Do you hope to avoid complex government regulations and reporting requirements?
2. How much control would you like? How much responsibility for running the business are you willing to share? What about sharing the profits?
3. Do you want to avoid special taxes?
4. Do you have all the skills needed to run the business?
5. Are you likely to get along with your co-owners over an extended period of time?
6. Is it important to you that the business survive you?
7. What are your financing needs and how do you plan to finance your company?
8. How much personal exposure to liability are you willing to accept? Do you feel uneasy about accepting personal liability for the actions of fellow owners?

No single form of ownership will give you everything you desire. You'll have to make some trade-offs. Because each option has both advantages and disadvantages, your job is to decide which one offers the features that are most important to you. In the following sections we'll compare three ownership options (sole proprietorship, partnership, corporation) on these eight dimensions.

Sole Proprietorship and Its Advantages

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In a sole proprietorship, you make all important decisions and are generally responsible for all day-to-day activities. In exchange for assuming all this responsibility, you get all the income earned by the business. Profits earned are taxed as personal income, so you don't have to pay any special federal and provincial income taxes.

Disadvantages of Sole Proprietorships

For many people, however, the sole proprietorship is not suitable. The flip side of enjoying complete control is having to supply all the different talents that may be necessary to make the business a success. And when you're gone, the business dissolves. You also have to rely on your own resources for financing: in effect, you are the business and any money borrowed by the business is loaned to you personally. Even more important, the sole proprietor bears unlimited liability for any losses incurred by the business. The principle of unlimited personal liability means that if the business incurs a debt or suffers a catastrophe (say, getting sued for causing an injury to someone), the owner is personally liable. As a sole proprietor, you put your personal assets (your bank account, your car, maybe even your home) at risk for the sake of your business. You can lessen your risk with insurance, yet your liability exposure can still be substantial. Given that Ben and Jerry decided to start their ice cream business together (and therefore the business was not owned by only one person), they could not set their company up as a sole proprietorship.

Partnership

A partnership (or general partnership) is a business owned jointly by two or more people. About 10 percent of U.S. businesses are partnerships[3] and though the vast majority are small, some are quite large. For example, the big four public accounting firms, Deloitte, PwC, Ernst & Young, and KPMG, are partnerships. Setting up a partnership is more complex than setting up a sole proprietorship, but it's still relatively easy and inexpensive. The cost varies according to size and complexity. It's possible to form a simple partnership without the help of a lawyer or an accountant, though it's usually a good idea to get professional advice.

Professionals can help you identify and resolve issues that may later create disputes among partners.

Provincial and federal governments also support small businesses and offer free resources as well as opportunities for funding. Canada Business Network (https://canadabusiness.ca/) (@canadabusiness #SMEPME) is a collaborative arrangement among federal departments and agencies, provincial and territorial governments and not-for-profit entities.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=68#h5p-14

It offers webinars and other learning events across the country. For example, Ontario's Small Business Access (https://www.ontario.ca/page/small-business-access), offers workshops, a help line, funding, and provides up-to-date information on legal requirements.

The Partnership Agreement

The impact of disputes can be lessened if the partners have executed a well-planned partnership agreement that specifies everyone's rights and responsibilities. The agreement might provide such details as the following:

- Amount of cash and other contributions to be made by each partner
- Division of partnership income (or loss)
- Partner responsibilities—who does what
- Conditions under which a partner can sell an interest in the company
- Conditions for dissolving the partnership
- Conditions for settling disputes

Unlimited Liability and the Partnership

A major problem with partnerships, as with sole proprietorships, is unlimited liability: in this case, each partner is personally liable not only for his or her own actions but also for the actions of all the partners. If your partner in an architectural firm makes a mistake that causes a structure to collapse, the loss your business incurs impacts you just as much as it would him or her. And here's the really bad news: if the business doesn't have the cash or other assets to cover losses, you can be personally sued for the amount owed. In other words, the party who suffered a loss because of the error can sue you for your personal assets. Many people are understandably reluctant to enter into partnerships because of unlimited liability. Certain forms of businesses allow owners to limit their liability. These include limited partnerships and corporations.

Limited Partnerships

The law permits business owners to form a limited partnership which has two types of partners: a single general partner who runs the business and is responsible for its liabilities, and any number of limited partners who have limited involvement in the business and whose losses are limited to the amount of their investment.

Advantages and Disadvantages of Partnerships

The partnership has several advantages over the sole proprietorship. First, it brings together a diverse group of talented individuals who share responsibility for running the business. Second, it makes financing easier: the business can draw on the financial resources of a number of individuals. The partners not only contribute funds to the business but can also use personal resources to secure bank loans. Finally, continuity needn't be an issue because partners can agree legally to allow the partnership to survive if one or more partners die.

Still, there are some negatives. First, as discussed earlier, partners are subject to unlimited liability. Second, being a partner means that you have to share decision making, and many people aren't comfortable with that situation. Not surprisingly, partners often have differences of opinion on how to run a business, and disagreements can escalate to the point of jeopardizing the continuance of the business. Third, in addition to sharing ideas, partners also share profits. This arrangement can work as long as all partners feel that they're being rewarded according to their efforts and accomplishments, but that isn't always the case. While the partnership form of ownership is viewed negatively by some, it was particularly appealing to Ben Cohen and Jerry Greenfield. Starting their ice cream business as a partnership was inexpensive and let them combine their limited financial resources and use their diverse skills and talents. As friends they trusted each other and welcomed shared decision making and profit sharing. They were also not reluctant to be held personally liable for each other's actions.

Corporation

A corporation (sometimes called a regular or C-corporation) differs from a sole proprietorship and a partnership because it's a legal entity that is entirely separate from the parties who own it. It can enter into binding contracts, buy and sell property, sue and be sued, be held responsible for its actions, and be taxed. Once businesses reach any substantial size, it is advantageous to organize as a corporation so that its owners can limit their liability. Corporations, then, tend to be far larger, on average, than businesses using other forms of ownership. Most large well-known businesses are corporations, but so are many of the smaller firms with which likely you do business.

Ownership and Stock

Corporations are owned by shareholders who invest money in the business by buying shares of stock. The portion of the corporation they own depends on the percentage of stock they hold. For example, if a corporation has issued 100 shares of stock, and you own 30 shares, you own 30 percent of the company. The shareholders elect a board of directors, a group of people (primarily from outside the corporation) who are legally responsible for governing the corporation. The board oversees the major policies and decisions made by the corporation, sets goals and holds management accountable for achieving them, and hires and evaluates the top executive, generally called the CEO (chief executive officer). The board also approves the distribution of income to shareholders in the form of cash payments called dividends.

Benefits of Incorporation

The corporate form of organization offers several advantages, including limited liability for shareholders, greater access to financial resources, specialized management, and continuity.

Limited Liability

The most important benefit of incorporation is the limited liability to which shareholders are exposed: they are not responsible for the obligations of the corporation, and they can lose no more than the amount that they have personally invested in the company. Limited liability would have been a big plus for the unfortunate individual whose business partner burned down their dry cleaning establishment. Had they been incorporated, the corporation would have been liable for the debts incurred by the fire. If the corporation didn't have enough money to pay the debt, the individual shareholders would not have been obligated to pay anything. They would have lost all the money that they'd invested in the business, but no more.

Financial Resources

Incorporation also makes it possible for businesses to raise funds by selling stock. This is a big advantage as a company grows and needs more funds to operate and compete. Depending on its size and financial strength, the corporation also has an advantage over other forms of business in getting bank loans. An established corporation can borrow its own funds, but when a small business needs a loan, the bank usually requires that it be guaranteed by its owners.

Specialized Management

Because of their size and ability to pay high sales commissions and benefits, corporations are generally able to attract more skilled and talented employees than are proprietorships and partnerships.

Continuity and Transferability

Another advantage of incorporation is continuity. Because the corporation has a legal life separate from the lives of its owners, it can (at least in theory) exist forever.

Transferring ownership of a corporation is easy: shareholders simply sell their stock to others. Some founders, however, want to restrict the transferability of their stock and so choose to operate as a privately-held corporation. The stock in these corporations is held by only a few individuals, who are not allowed to sell it to the general public.

Companies with no such restrictions on stock sales are called public corporations; stock is available for sale to the general public.

Drawbacks to Incorporation

Like sole proprietorships and partnerships, corporations have both positive and negative aspects. In sole proprietorships and partnerships, for instance, the individuals who own and manage a business are the same people. Corporate managers, however, don't necessarily own stock, and shareholders don't necessarily work for the company. This situation can be troublesome if the goals of the two groups differ significantly.

Managers, for example, are often more interested in career advancement than the overall profitability of the company. Stockholders might care more about profits without regard for the well-being of employees. This situation is known as the agency problem, a conflict of interest inherent in a relationship in which one party is supposed to act in the best interest of the other. It is often quite difficult to prevent self-interest from entering into these situations.

Another drawback to incorporation—one that often discourages small businesses from incorporating—is the fact that corporations are more costly to set up. When you combine filing and licensing fees with accounting and attorney fees, incorporating a business could set you back by $1,000 to $6,000 or more depending on the size and scope of your business.[4] Additionally, corporations are subject to levels of regulation and governmental oversight that can place a burden on small businesses. Finally, corporations are subject to what's generally called "double taxation." Corporations are taxed by the federal and provincial governments on their earnings. When these earnings are distributed as dividends, the shareholders pay taxes on these dividends. Corporate profits are thus taxed twice—the corporation pays the taxes the first time and the shareholders pay the taxes the second time.

The Canadian Comparison

"Incorporation: Tax savings, but more paperwork", a 2017 article in The Globe and Mail, puts incorporation in to the Canadian perspective:

> In Ontario, an incorporated business pays a tax rate of 15 per cent on the first $500,000 of income each year, thanks to the small business tax deduction, and 26.5 per cent for anything beyond that. Rates vary by province. A lower tax rate is one of the key advantages to incorporating a business. However, accountants make the distinction that the taxes aren't being saved, but instead deferred. That's because, when the money is taken out of the corporation for personal use, through salary or dividends, the individual winds up paying approximately the same tax rate as if they were a sole proprietor. It's known as the "theory of integration" in the Canadian tax system.
>
> Most accountants recommend business owners incorporate if they can afford to leave money in the company longer-term with the goal of watching the value of the assets grow.
>
> Another tax advantage comes when it's time to sell the business. The shares of most Canadian private corporations are eligible for a lifetime capital-gains exemption. In 2016, that exemption amounts to the first $824,176 of capital gains from personal income tax, per shareholder. If the business were a sole proprietorship, any gain from the sale of a private corporation would be taxed.
>
> Another advantage to incorporating is the opportunity to use income splitting among family members. If one spouse makes more money, you can income-split. Over all, both spouses will be in a lower income-tax bracket.
>
> Another advantage of incorporation, beyond taxes, is the ability to shift liability to the corporation and away from the individual. Incorporating can also add credibility; some larger companies require contractors to be incorporated before they can be hired.
>
> The disadvantages to incorporation are increased paperwork and administration. That includes the one-time cost to set up the corporation, including accounting and legal fees, which can run to more than $1,000. Owners also have to file two tax returns, a personal one and a more complicated one for the business.

Five years after starting their ice cream business, Ben Cohen and Jerry Greenfield evaluated the pros and cons of the corporate form of ownership, and the "pros" won. The primary motivator was the need to raise funds to build a $2 million manufacturing facility. Not only did Ben and Jerry decide to switch from a partnership to a corporation, but they also decided to sell shares of stock to the public (and thus become a public corporation). Their sale of stock to the public was a bit unusual: Ben and Jerry wanted the community to own the company, so instead of offering the stock to anyone interested in buying a share, they offered stock to residents of Vermont only. Ben believed that "business has a responsibility to give back to the community from which it draws its support”.[5] He wanted the company to be owned by those who lined up in the gas station to buy cones. The stock was so popular that one in every hundred Vermont families bought stock in the company.[6] Eventually, as the company continued to expand, the stock was sold on a national level.

Other Types of Business Ownership

In addition to the three commonly adopted forms of business organization—sole proprietorship, partnership, and regular corporations—some business owners select other forms of organization to meet their particular needs. We'll look at several of these options:

- Limited liability companies
- Cooperatives
- Not-for-profit corporations

Limited Liability Companies

How would you like a legal form of organization that provides the attractive features of the three common forms of organization (corporation, sole proprietorship and partnership) and avoids the unattractive features of these three organization forms? The limited liability company (LLC) accomplishes exactly that. This form provides business owners with limited liability (a key advantage of corporations) and no “double taxation” (a key advantage of sole proprietorships and partnerships). Let's look at the LLC in more detail.

In 1977, Wyoming became the first state to allow businesses to operate as limited liability companies. Twenty years later, in 1997, Hawaii became the last state to give its approval to the new organization form. Since then, the limited liability company has increased in popularity. Its rapid growth was fueled in part by changes in state statutes that permit a limited liability company to have just one member. The trend to LLCs can be witnessed by reading company names on the side of trucks or on storefronts in your city. It is common to see names such as Jim Evans Tree Care, LLC, and For-Cats-Only Veterinary Clinic, LLC. But LLCs are not limited to small businesses. Companies such as Crayola, Domino's Pizza, Ritz-Carlton Hotel Company, and iSold It (which helps people sell their unwanted belongings on eBay) are operating under the limited liability form of organization. In a limited liability company, owners (called members rather than shareholders) are not personally liable for debts of the company, and its earnings are taxed only once, at the personal level (thereby eliminating double taxation).

We have touted the benefits of limited liability protection for an LLC. We now need to point out some circumstances under which an LLC member (or a shareholder in a corporation) might be held personally liable for the debts of his or her company. A business owner can be held personally liable if he or she:

- Personally guarantees a business debt or bank loan which the company fails to pay.
- Fails to pay employment taxes to the government.
- Engages in fraudulent or illegal behavior that harms the company or someone else.
- Does not treat the company as a separate legal entity, for example, uses company assets for personal uses.

Cooperatives

Figure 4.2: Source: MEC in Ottawa retrieved from https://commons.wikimedia.org/

A cooperative (also known as a co-op) is a business owned and controlled by those who use its services. Individuals and firms who belong to the cooperative join together to market products, purchase supplies, and provide services for its members. If run correctly, cooperatives increase profits for its producer-members and lower costs for its consumer-members. Cooperatives are fairly common in the agricultural community. For example, some 750 cranberry and grapefruit member growers market their cranberry sauce, fruit juices, and dried cranberries through the Ocean Spray Cooperative.[7] More than three hundred thousand farmers obtain products they need for production—feed, seed, fertilizer, farm supplies, fuel—through the Southern States Cooperative.[8] Co-ops also exist outside agriculture. For example, MEC (Mountain Equipment Co-op), which sells quality outdoor gear, has more than 5 million members across the country, who have each paid $5 for their lifetime memberships.The company shares its financial success with its members and also gives back 1% of its sales to maintain participation in the outdoors.

Not-for-Profit Corporations

A not-for-profit corporation (sometimes called a nonprofit) is an organization formed to serve some public purpose rather than for financial gain. As long as the organization's activity is for charitable, religious, educational, scientific, or literary purposes, it can be exempt from paying income taxes. Additionally, individuals and other organizations that contribute to the not-for-profit corporation can take a tax deduction for those contributions. The types of groups that normally apply for nonprofit status vary widely and include churches, synagogues, mosques, and other places of worship; museums; universities; and conservation groups.

Since Statistics Canada ended its deep collection of nonprofit statistics in 2008, the most recent data available is:

- 170,000 charitable and non profit organizations in Canada
- 85,000 of these are registered charities (recognized by the Canada Revenue Agency).
- The charitable and nonprofit sector contributes an average of 8.1% of total Canadian GDP, more than the retail trade industry and close to the value of the mining, oil and gas extraction industry
- Two million Canadians are employed in the charitable and nonprofit sector
- Over 13 million people volunteer for charities and nonprofits

Do you think these numbers have increased or decreased over the last decade? Why?

Mergers and Acquisitions

Show What You Know

Track how quickly you can match some of the more recent, larger mergers or major corporations.

If you do not see the embedded match game, access it: https://quizlet.com/274512349/match.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=68#h5p-15

The headline read, "Wanted: More than 2,000 in Google hiring spree".[9] The largest Web search engine in the world was disclosing its plans to grow internally and increase its workforce by more than 2,000 people, with half of the hires coming from the United States and the other half coming from other countries. The added employees will help the company expand into new markets and battle for global talent in the competitive Internet information providers industry. When properly executed, internal growth benefits the firm.

An alternative approach to growth is to merge with or acquire another company. The rationale behind growth through merger or acquisition is that 1 + 1 = 3: the combined company is more valuable than the sum of the two separate companies. This rationale is attractive to companies facing competitive pressures. To grab a bigger share of the market and improve profitability, companies will want to become more cost efficient by combining with other companies.

Though they are often used as if they're synonymous, the terms merger and acquisition mean slightly different things. A merger occurs when two companies combine to form a new company. An acquisition is the purchase of one company by another.

The Canadian Landscape

In June 2013, Shoppers Drug Mart, Canada's biggest pharmacy chain merged with Loblaw, Canada's largest grocery retailer, in a 12.4 billion dollar deal. Rather than cutting into each other's market share, the deal allows the two companies to play on each other's strengths. Shoppers has about $1 billion in food sales annually, versus Loblaw's $30 billion. But Loblaw's share of the pharmacy market is only five per cent, so adding Shoppers health products and services to Loblaw grocery stores allows the food retailer to expand its services in what it sees as a growing sector: health, wellness and nutrition. Contrast this merger with an acquisition in that same year. Sobey's acquired 200 Safeway stores in Western Canada under a 5.8 billion dollar deal. According to news reports, along with 213 Safeway grocery stores — more than 60 percent of which are in Calgary, Vancouver, Edmonton and Winnipeg — Sobeys will also acquire:

- 199 in-store pharmacies;
- 62 gas stations;
- 10 liquor stores;
- 4 primary distribution centres and a related wholesale business; and
- 12 manufacturing facilities.

Sobeys will also get $1.8 billion worth of real estate in the deal.

Another example of an acquisition is the purchase of Reebok by Adidas for $3.8 billion.[10] The deal was expected to give Adidas a stronger presence in North America and help the company compete with rival Nike. Once this acquisition was completed, Reebok as a company ceased to exist, though Adidas still sells shoes under the Reebok brand.

Motives Behind Mergers and Acquisitions

Companies are motivated to merge or acquire other companies for a number of reasons, including the following.

Gain Complementary Products

- Shoppers Drug Mart began to sell President's Choice products in its merger with Loblaw.
- Loblaw is able to add Shoppers health care products to its shelves.
- Sobey's gains Safeway's gas stations and liquors stores in its acquisition.

Attain New Markets or Distribution Channels

- Sobey's acquired access to 12 manufacturing facilities, 4 distribution centres, and a related wholesale business.
- Loblaw increases access to urban centres where Shoppers are already located, bringing a wider variety of products to customers in densely populated areas.

Realize Synergies

- Integration of the companies' loyalty programs will provide the two with a vast knowledge base of consumers' buying habits and provide economies of scale — which, the companies estimate, will translate into savings of about $300 million annually.
- Loblaw's share of the pharmacy market is only five per cent so adding Shoppers health products and services to its grocery stores will allow the food retailer to expand its services in what it sees as a growing sector: health, wellness and nutrition.

The Less-Friendly Option

Hostile Takeovers: Ben and Jerry's

What happens, though, if one company wants to acquire another company, but that company doesn't want to be acquired? The outcome could be a hostile takeover—an act of assuming control that's resisted by the targeted company's management and its board of directors. Ben Cohen and Jerry Greenfield, the Ice Cream Men from above, found themselves in one of these situations: Unilever—a very large Dutch/British company that owns three ice cream brands—wanted to buy Ben & Jerry's, against the founders' wishes. Most of the Ben & Jerry's stockholders sided with Unilever. They had little confidence in the ability of Ben Cohen and Jerry Greenfield to continue managing the company and were frustrated with the firm's social-mission focus. The stockholders liked Unilever's offer to buy their Ben & Jerry's stock at almost twice its current market price and wanted to take their profits. In the end, Unilever won; Ben & Jerry's was acquired by Unilever in a hostile takeover.[11] Despite fears that the company's social mission would end, it didn't happen. Though neither Ben Cohen nor Jerry Greenfield are involved in the current management of the company, they have returned to their social activism roots and are heavily involved in numerous social initiatives sponsored by the company.

Solidifying the Vocabulary

Use this quick activity to ensure you understand the vocabulary related to mergers and acquisitions.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=68#h5p-16

Key Takeaways / Important Terms and Concepts

1. A sole proprietorship is a business owned by only one person.
    - Advantages include: complete control for the owner, easy and inexpensive to form, and owner gets to keep all of the profits.
    - Disadvantages include: unlimited liability for the owner, complete responsibility for talent and financing, and business dissolves if the owner dies.
2. A general partnership is a business owned jointly by two or more people.
    - Advantages include: more resources and talents come with an increase in partners, and the business can continue even after the death of a partner.
    - Disadvantages include: partnership disputes, unlimited liability, and shared profits.
3. A limited partnership has a single general partner who runs the business and is responsible for its liabilities, plus any number of limited partners who have limited involvement in the business and whose losses are limited to the amount of their investment.
4. A corporation is a legal entity that's separate from the parties who own it, the shareholders who invest by buying shares of stock. Corporations are governed by a Board of Directors, elected by the shareholders.
    - Advantages include: limited liability, easier access to financing, and unlimited life for the corporation.
    - Disadvantages include: the agency problem, double taxation, and incorporation expenses and regulations.
5. A limited liability company (LLC) is similar to an C-corporation, but it has fewer rules and restrictions than an C-corporation. For example, an LLC can have any number of members.

6. A cooperative is a business owned and controlled by those who use its services. Individuals and firms who belong to the cooperative join together to market products, purchase supplies, and provide services for its members.
7. A not-for-profit corporation is an organization formed to serve some public purpose rather than for financial gain. It enjoys favorable tax treatment.
8. A merger occurs when two companies combine to form a new company.
9. An acquisition is the purchase of one company by another with no new company being formed. A hostile takeover occurs when a company is purchased even though the company's management and Board of Directors do not want to be acquired.

5. Entrepreneurship: Starting a Business

Learning Objectives

By the end of the chapter, you should be able to:

1. Define entrepreneur and describe the three characteristics of entrepreneurial activity.
2. Identify five potential advantages to starting your own business.
3. Define a small business and explain the importance of small businesses to the Canadian economy.
4. Explain why small businesses tend to foster innovation more effectively than large ones.
5. Describe the goods-producing and service-producing sectors of an economy.
6. Explain what it takes to start a business and evaluate the advantages and disadvantages starting a business from scratch, buying an existing business, or obtaining a franchise.
7. Explain why some businesses fail.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=72#h5p-17

Arts and Crafts for Adults: Collective Beer

Canadian Business often profiles innovative entrepreneurs and gathered 15 of its finest profiles online (http://www.canadianbusiness.com/innovation/canadian-entrepreneur-success-stories/). Here is one of those spotlights:

Matt Johnston was stone-cold sober when he signed the lease to a 55,000-square-foot brewery in Hamilton and sunk major money into beer-making equipment, though his actions might have suggested a tipple or two. He hadn't even secured a business loan yet.

Figure 5.1: Collective Arts Brewery retrieved from http://ontariobev.net

But how was he to know his plan to expand his craft beer company would get rejected by almost every major Canadian bank? Or that structural setbacks would delay construction by six months and put him $1 million over budget? "It was one of the scarier points of our journey to date," Johnston admits.

Things were better back in September 2013, when the 41-year-old launched his company, Collective Arts Brewing (http://collectiveartsbrewing.com/), with co-founder Bob Russell. The Hamilton-born buddies pooled their expertise (Johnston knew ales; Russell knew art) to create a beer that would connect drinkers to creative types by featuring an ever-changing array of wall-art-worthy labels designed and illustrated by artists and musicians. Scan a label with a free app called Blippar (https://blippar.com/) (no ugly QR code here), and you'll see a music video or artist's bio.

Since inception, more than 350 labels have been carefully culled from thousands of submissions; featured artists have included Canadian band The Strumbellas (http://www.thestrumbellas.ca/), Spanish illustrator Eduardo Bertone (http://www.bertoneeduardo.com) and U.S. painter Lola Gil (http://www.lolafineart.com/). "Craft beer is meant to be about creativity, so why put the same boring label on the bottles for the next 10 years?" says Johnston.

The beer is pretty good, too. Rhyme & Reason—their flagship hop-happy extra pale ale with notes of pine and tropical fruits, was initially produced by brewer Nickel Brook Brewery in Burlington, Ont. It is one of the top-selling craft beers at the Liquor Control Board of Ontario. Their second brew, the citrus-infused Saint of Circumstance, is in the Top 30.

Given Collective Arts' surging popularity, Nickel Brook couldn't keep up with demand. Collective Arts had to decide: find a new supplier or build something for themselves. Since Nickel Brook was looking to expand as well, they teamed up to leverage their strengths and resources, and bought an empty space once occupied by former beer giant Lakeport Brewery Company in Hamilton. "We sort of said to ourselves, we can't succeed as individuals. Building a brewery is an expensive undertaking, and neither of us could afford it, so it only made sense to work together," says Johnston.

The partnership proved even more beneficial when they found out the land couldn't support the weight of their tanks, meaning 6,000 square feet of concrete would have to be cut out of the foundation so 150 helical steel plates could be screwed into more stable soil, increasing the ground's bearing capacity. Having the resources of two companies helped mitigate the cost. "When you partner up, you cut the risk in half and double the chance of success," Johnston says.

And then there was the problem of getting a loan. Any small business, particularly a young and revenueless one, will face a financing fight. For craft brewers, it's more like a combat mission. There are currently 166 craft brewers in Ontario vying for investors, shelf space and bar taps. Craft beer sales in the province may have grown by 575% from 2006 to 2013, but they still only represented 4% of all beer sales.

Luckily, Collective Arts found a saviour. After being rejected by at least five Canadian banks, one foreign financial institution believed in their grassroots idea and contributed a little less than half of the $7 million investment they needed to get the new brewery going. The rest of the funds come from the two breweries themselves.

They're now set to look west, where markets appear more encouraging (craft beer accounts for around 15% of British Columbia's beer sales). Their good-looking beer will hit the four western provinces this year (article written in 2015), with distribution to all of Canada and some U.S. states by 2016.

Their next big move is cutting the ribbon for the new brewery this spring. They named it Arts & Science Brewing, as a nod to the craft and chemistry behind beer. While the two companies will operate separately, they will share 30 employees and the production facilities, which can produce up to 12 million bottles in the first year. The site also includes a 400-person music venue, an art gallery, a tap room and a beer garden—a "dream space" where they can directly sell their bevy of brews, plus invite some of their favourite bands to play. The scares he's had running this business have left a bitter taste, but so long as the beers attract new fans for his featured artists, he'll swallow it. "When someone sees our label and tweets, 'I love The Strumbellas,' that's a win for me."

The Nature of Entrepreneurship

If we look a little more closely at the definition of entrepreneurship, we can identify three characteristics of entrepreneurial activity:[1]

1. Innovation. Entrepreneurship generally means offering a new product, applying a new technique or technology, opening a new market, or developing a new form of organization for the purpose of producing or enhancing a product.
2. Running a business. A business, as we saw in Chapter 1 "The Foundations of Business," combines resources to produce goods or services. Entrepreneurship means setting up a business to make a profit.
3. Risk taking. The term risk means that the outcome of the entrepreneurial venture can't be known. Entrepreneurs, therefore, are always working under a certain degree of uncertainty, and they can't know the outcomes of many of their decisions. Consequently, many of the steps they take are motivated mainly by their confidence in the innovation and in their understanding of the business environment in which they're operating.

It is easy to recognize these characteristics in the entrepreneurial experience of the craft brewers. They certainly had an innovative idea. But was it a good business idea? In a practical sense, a "good" business idea has to become something more than just an idea. If, like Collective Arts, you're interested in generating income from your idea, you'll probably need to turn it into a product—something that you can market because it satisfies a need. If you want to develop a product, you'll need some kind of organization to coordinate the resources necessary to make it a reality (in other words, a business). Risk enters the equation when you make the decision to start up a business and when you commit yourself to managing it.

To jumpstart your thinking around entrepreneurship, take this short quiz (https://www.qzzr.com/c/quiz/68438/ce06e251-4753-49ea-9f25-9889a7fa667a) to align your thinking to Richard Branson, Warren Buffett, Marissa Mayer, or another famous businessperson. Please note: This quiz is very general and not scientific. It is just to prompt your thinking.

A Few Things to Know About Going into Business for Yourself

Mark Zuckerberg founded Facebook while a student at Harvard. By age 27 he built up a personal wealth of $13.5 billion. By age 31, his net worth was $37.5 billion. Regardless of hurdles his company faced in early 2018, his success as an entrepreneur is solidified.

So what about you? Do you ever wonder what it would be like to start your own business? You might even turn into a "serial entrepreneur" like Marcia Kilgore.[2] After high school, she moved from Canada to New York City to attend Columbia University. But when her financial aid was delayed, Marcia abandoned her plans to attend college and took a job as a personal trainer (a natural occupation for a former bodybuilder and middleweight title holder). But things got boring in the summer when her wealthy clients left the city for the Hamptons. To keep busy, she took a skin care course at a Manhattan cosmetology institute. As a teenager, she was self-conscious about her complexion and wanted to know how to treat it herself. She learned how to give facials and work with natural remedies. She started giving facials to her fitness clients who were thrilled with the results. As demand for her services exploded, she started her first business—Bliss Spa—and picked up celebrity clients, including Madonna, Oprah Winfrey, and Jennifer Lopez. The business went international, and she sold it for more than $30 million.[3]

But the story doesn't end here; she launched two more companies: Soap and Glory, a supplier of affordable beauty products sold at Target, and FitFlops, which sells sandals that tone and tighten your leg muscles as you walk. Oprah loves Kilgore's sandals and plugged them on her show.[4] You can't get a better endorsement than that. Kilgore never did finish college, but when asked if she would follow the same path again, she said, "If I had to decide what to do all over again, I would make the same choices…I found by accident what I'm good at, and I'm glad I did."

So, a few questions to consider if you want to go into business for yourself:

- How do I come up with a business idea?
- Should I build a business from scratch, buy an existing business, or invest in a franchise?
- What steps are involved in developing a business plan?
- Where could I find help in getting my business started?
- How can I increase the likelihood that I'll succeed?

In this chapter, we'll provide some answers to questions like these.

Why Start Your Own Business?

What sort of characteristics distinguishes those who start businesses from those who don't? Or, more to the point, why do some people actually follow through on the desire to start up their own businesses? The most common reasons for starting a business are the following:

- To be your own boss
- To accommodate a desired lifestyle
- To achieve financial independence
- To enjoy creative freedom
- To use your skills and knowledge

How can you translate characteristics into potential success? Experts suggest that you assess your strengths and weaknesses by asking yourself a few relevant questions:[5]

- Am I a self-starter? You'll need to develop and follow through on your ideas.
- How well do I get along with different personalities? Strong working relationships with a variety of people are crucial.
- How good am I at making decisions? Especially under pressure…
- Do I have the physical and emotional stamina? Expect six or seven work days of about twelve hours every week.
- How well do I plan and organize? Poor planning is the culprit in most business failures.
- How will my business affect my family? Family members need to know what to expect: long hours and, at least initially, a more modest standard of living.

Before we discuss why businesses fail we should consider why a huge number of business ideas never even make it to the grand opening. One business analyst cites four reservations (or fears) that prevent people from starting businesses:[6]

- Money. Without cash, you can't get very far. What to do: line up initial financing early or at least have done enough research to have a plan to raise money.
- Security. A lot of people don't want to sacrifice the steady income that comes with the nine-to-five job. What to do: don't give up your day job. Run the business part-time or connect with someone to help run your business – a "co-founder".
- Competition. A lot of people don't know how to distinguish their business ideas from similar ideas. What to do: figure out how to do something cheaper, faster, or better.
- Lack of ideas. Some people simply don't know what sort of business they want to get into. What to do: find out what trends are successful. Turn a hobby into a business. Think about a franchise. Find a solution to something that annoys you – entrepreneurs call this a "pain point" – and try to turn it into a business.

If you're still interested in going into business for yourself, try to regard such drawbacks as mere obstacles to be overcome by a combination of planning and creative thinking.

Sources of Early-Stage Financing

As noted above, many businesses fail, or never get started, due to a lack of funds. But where can an entrepreneur raise money to start a business? Many first-time entrepreneurs are financed by friends and family, at least in the very early stages. Others may borrow through their personal credit cards, though quite often, high interest rates make this approach unattractive or too expensive for the new business to afford.

An entrepreneur with a great idea may win funding through a pitch competition; local municipalities and government agencies understand that economic growth depends on successful new businesses, and so they will often conduct such competitions in the hopes of attracting them.

Crowd funding has become more common as a means of raising capital. An entrepreneur using this approach would typically utilize a crowd funding platform like Kickstarter or GoFundMe to attract investors. The entrepreneur might offer tokens of appreciation in exchange for funds, or perhaps might offer an ownership stake for a substantial enough investment. Take a few moments to peruse Kickstarter (https://www.kickstarter.com) or another site and see what types of businesses are proposed in your area or which are trending globally.

Some entrepreneurs receive funding from angel investors, affluent investors who provide capital to start-ups in exchange for an ownership position in the company. Many angels are successful entrepreneurs themselves and invest not only to make money, but also to help other aspiring business owners to succeed.

Venture capital firms also invest in start-up companies, although usually at a somewhat later stage and in larger dollar amounts than would be typical of angel investors. Like angels, venture firms also take an ownership position in the company. They tend to have a higher expectation of making a return on their money than do angel investors.

Distinguishing Entrepreneurs from Small Business Owners

Though most entrepreneurial ventures begin as small businesses, not all small business owners are entrepreneurs. Entrepreneurs are innovators who start companies to create new or improved products. They strive to meet a need that's not being met, and their goal is to grow the business and eventually expand into other markets.

In contrast, many people either start or buy small businesses for the sole purpose of providing an income for themselves and their families. They do not intend to be particularly innovative, nor do they plan to expand significantly. This desire to operate is what's sometimes called a "lifestyle business"[7]. The neighbourhood pizza parlour or beauty shop, the self-employed consultant who works out of the home, and even a local printing company—many of these are typically lifestyle businesses.

The Importance of Small Business to the Canadian Economy

What Is a "Small Business"?

To assess the value of small businesses to the Canadian economy, we first need to know what constitutes a small business. Let's start by looking at the criteria used by Industry Canada. In 2012 Industry Canada defined it: "small business" is firms that have fewer than 100 employees. A small business is one that is independently owned and operated, exerting little influence in its industry.

Why Are Small Businesses Important?

However, small business constitutes a force in the Canadian and other economies. The millions of individuals who have started businesses have helped shape the business world as we know it today. Some small business founders like Henry Ford and Thomas Edison have even gained places in history. Others, including Bill Gates (Microsoft), Mike Lazaridis (Research in Motion), Steve Jobs (Apple Computer), and Larry Page and Sergey Brin (Google), have changed the way global business is done today.

Aside from contributions to our general economic well-being, founders of small businesses also contribute to growth and vitality in specific areas of economic and socio-economic development. In particular, small businesses do the following:

- Create jobs
- Spark innovation
- Provide opportunities for many people, including women and minorities, to achieve financial success and independence

In addition, they complement the economic activity of large organizations by providing them with components, services, and distribution of their products. Let's take a closer look at each of these contributions.

Job Creation

The majority of Canadian workers first entered the business world working for small businesses. Although the split between those working in small companies and those working in big companies is about even, small firms hire more frequently and fire more frequently than do big companies.[8] Why is this true? At any given point in time, lots of small companies are started and some expand. These small companies need workers and so hiring takes place. But the survival and expansion rates for small firms is poor, and so, again at any given point in time, many small businesses close or contract and workers lose their jobs. Fortunately, over time more jobs are added by small firms than are taken away, which results in a net increase in the number of workers.

The size of the net increase in the number of workers for any given year depends on a number of factors, with the economy being at the top of the list. A strong economy encourages individuals to start small businesses and expand existing small companies, which adds to the workforce. A weak economy does just the opposite: discourages start-ups and expansions, which decreases the workforce through layoffs.

Innovation

Given the financial resources available to large businesses, you'd expect them to introduce virtually all the new products that hit the market. Yet according to the United States's Small Business Administration (SBA), small companies develop more patents per employee than do larger companies. During a recent four-year period, large firms generated 1.7 patents per hundred employees, while small firms generated an impressive 26.5 patents per employee.[9] Although similar statistics are not available for Canada, our business practices tend to align with our neighbours in the United States.

Over the years, the list of important innovations by small firms has included the airplane, air-conditioning, DNA "fingerprinting", and overnight national delivery.[10]

Figure 5.2: Amazon Go store in Seattle WA. CC BY Licence | https://en.wikipedia.org

Small business owners are also particularly adept at finding new ways of doing old things. In 1994, for example, a young computer-science graduate working on Wall Street came up with the novel idea of selling books over the Internet. During the first year of operations, sales at Jeff Bezos' new company, Amazon.com, reached half a million dollars. In less than twenty years, annual sales had topped $107 billion.[11] Not only did his innovative approach to online retailing make Bezos enormously rich, but it also established a viable model for the e-commerce industry. In 2018, Amazon's model is creeping into the physical. Shortly after entering the grocery market by acquiring Whole Foods, it protoyped a cashier-less and checkout-less store where your purchases are charged against your Amazon account via an app. It hopes to revolutionize grocery shopping just as it did book buying.

Why are small businesses so innovative? For one thing, they tend to offer environments that appeal to individuals with the talent to invent new products or improve the way things are done. Fast decision making is encouraged, their research programs tend to be focused, and their compensation structures typically reward top performers.

According to one SBA study, the supportive environments of small firms are roughly thirteen times more innovative per employee than the less innovation-friendly environments in which large firms traditionally operate.[12]

The success of small businesses in fostering creativity has not gone unnoticed by big businesses. In fact, many large companies have responded by downsizing to act more like small companies. Some large organizations now have separate work units whose purpose is to spark innovation. Individuals working in these units can focus their attention on creating new products that can then be developed by the company.

Opportunities for Women

Small business is the portal through which many people enter the economic mainstream. Business ownership allows individuals to achieve financial success, as well as pride in their accomplishments. While the majority of small businesses are still owned by white males, the past two decades have seen a substantial increase in the number of businesses owned by women.

Canada's 2018 budget had continued investment in women entrepreneurs. On February 28, 2018, the Financial Post reported:

"By far, the largest net new impact on Canada's entrepreneurial class is the $1.65 billion in new financing being made available to women business owners, to be delivered over three years through the Business Development Bank of Canada and Export Development Canada."

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https://pressbooks.nscc.ca/businessfuncdn/?p=72#h5p-18

What Industries Are Small Businesses In?

If you want to start a new business, you probably should avoid certain types of businesses. You'd have a hard time, for example, setting up a new company to make automobiles or aluminum, because you'd have to make tremendous investments in property, plant, and equipment, and raise an enormous amount of capital to pay your workforce. These large, up-front investments present barriers to entry.

Fortunately, plenty of opportunities are still available. Many types of businesses require reasonable initial investments, and not surprisingly, these are the ones that usually present attractive small business opportunities.

Industries by Sector

Let's define an industry as a group of companies that compete with one another to sell similar products. We'll focus on the relationship between a small business and the industry in which it operates, dividing businesses into two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.

- The goods-producing sector includes all businesses that produce tangible goods. Generally speaking, companies in this sector are involved in manufacturing, construction, and agriculture.
- The service-producing sector includes all businesses that provide services but don't make tangible goods. They may be involved in retail and wholesale trade, transportation, finance, entertainment, recreation, accommodations, food service, and any number of other ventures.

About 20% of small businesses in the United States are concentrated in the goods-producing sector. The remaining 80% are in the service sector.[13] The high concentration of small businesses in the service-producing sector reflects the makeup of the overall U.S. economy. Over the past fifty years, the service-producing sector has been growing at an impressive rate. In 1960, for example, the goods-producing sector accounted for 38 percent of GDP, the service-producing sector for 62 percent. By 2015, the balance had shifted dramatically, with the goods-producing sector accounting for only about 21 percent of GDP.[14]

Goods-Producing Sector

The largest areas of the goods-producing sector are construction and manufacturing. Construction businesses are often started by skilled workers, such as electricians, painters, plumbers, and home builders, and they generally work on local projects. Though manufacturing is primarily the domain of large businesses, there are exceptions. BTIO/Realityworks, for example, is a manufacturing enterprise (components come from Ohio and China, and assembly is done in Wisconsin).

How about making something out of trash? Daniel Blake never followed his mother's advice at dinner when she told him to eat everything on his plate. When he served as a missionary in Puerto Rico, Aruba, Bonaire, and Curacao after his first year in college, he noticed that the families he stayed with didn't either. But they didn't throw their uneaten food into the trash. Instead they put it on a compost pile and used the mulch to nourish their vegetable gardens and fruit trees. While eating at an all-you-can-eat breakfast buffet back home at Brigham Young University, Blake was amazed to see volumes of uneaten food in the trash. This triggered an idea: why not turn the trash into money? Two years later, he was running his company—EcoScraps—collecting 40 tons of food scraps a day from 75 grocers and turning it into high-quality potting soil that he sells online and to nurseries. His profit has reach almost half a million dollars on sales of $1.5 million.[15]

Service-Producing Sector

Many small businesses in this sector are retailers—they buy goods from other firms and sell them to consumers, in stores, by phone, through direct mailings, or over the Internet. In fact, entrepreneurs are turning increasingly to the Internet as a venue for start-up ventures. Take Tony Roeder, for example, who had a fascination with the red Radio Flyer wagons that many of today's adults had owned as children. In 1998, he started an online store through Yahoo! to sell red wagons from his home. In three years, he turned his online store into a million-dollar business.[16]

Other small business owners in this sector are wholesalers—they sell products to businesses that buy them for resale or for company use. A local bakery, for example, is acting as a wholesaler when it sells desserts to a restaurant, which then resells them to its customers. A small business that buys flowers from a local grower (the manufacturer) and resells them to a retail store is another example of a wholesaler.

A high proportion of small businesses in this sector provide professional, business, or personal services. Doctors and dentists are part of the service industry, as are insurance agents, accountants, and lawyers. So are businesses that provide personal services, such as dry cleaning and hairdressing.

David Marcks, for example, entered the service industry about fourteen years ago when he learned that his border collie enjoyed chasing geese at the golf course where he worked. While geese are lovely to look at, they can make a mess of tees, fairways, and greens. That's where Marcks' company, Geese Police, comes in: Marcks employs specially trained dogs to chase the geese away. He now has twenty-seven trucks, thirty-two border collies, and five offices. Golf courses account for only about 5 percent of his business, as his dogs now patrol corporate parks and playgrounds as well.[17]

Advantages and Disadvantages of Business Ownership

Do you want to be a business owner someday? Before deciding, you might want to consider the following advantages and disadvantages of business ownership.[18]

Advantages of Small Business Ownership

Being a business owner can be extremely rewarding. Having the courage to take a risk and start a venture is part of the North American dream. Success brings with it many advantages:

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https://pressbooks.nscc.ca/businessfuncdn/?p=72#h5p-19

Disadvantages of Small Business Ownership

As the little boy said when he got off his first roller-coaster ride, "I like the ups but not the downs!" Here are some of the risks you run if you want to start a small business:

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In spite of these and other disadvantages, most small business owners are pleased with their decision to start a business. A survey conducted by the Wall Street Journal and Cicco and Associates indicates that small business owners and top-level corporate executives agree overwhelmingly that small business owners have a more satisfying business experience.

Interestingly, the researchers had fully expected to find that small business owners were happy with their choices; they were, however, surprised at the number of corporate executives who believed that the grass was greener in the world of small business ownership.[19]

Starting a Business

Starting a business takes talent, determination, hard work, and persistence. It also requires a lot of research and planning. Before starting your business, you should appraise your strengths and weaknesses and assess your personal goals to determine whether business ownership is for you.[20]

Questions to Ask Before You Start a Business

If you're interested in starting a business, you need to make decisions even before you bring your talent, determination, hard work, and persistence to bear on your project.

Here are the basic questions you'll need to address:

- What, exactly, is my business idea? Is it feasible?
- What industry do I want to enter?
- What will be my competitive advantage?
- Do I want to start a new business, buy an existing one, or buy a franchise?
- What form of business organization do I want?

After making these decisions, you'll be ready to take the most important step in the entire process of starting a business: you must describe your future business in the form of a business plan—a document that identifies the goals of your proposed business and explains how these goals will be achieved. Think of a business plan as a blueprint for a proposed company: it shows how you intend to build the company and how you intend to make sure that it's sturdy. You must also take a second crucial step before you actually start up your business: You need to get financing—the money that you'll need to get your business off the ground.

The Business Idea

For some people, coming up with a great business idea is a gratifying adventure. For most, however, it's a daunting task. The key to coming up with a business idea is identifying something that customers want—or, perhaps more importantly, filling an unmet need. Your business will probably survive only if its purpose is to satisfy its customers—the ultimate users of its goods or services. In coming up with a business idea, don't ask, "What do we want to sell?" but rather, "What does the customer want to buy?"[21]

To come up with an innovative business idea, you need to be creative. The idea itself can come from various sources. Prior experience accounts for the bulk of new business idea and also increases your chances of success. Take Sam Walton, the late founder of Wal-Mart. He began his retailing career at JCPenney and then became a successful franchisor of a Ben Franklin five-and-dime store. In 1962, he came up with the idea of opening large stores in rural areas, with low costs and heavy discounts. He founded his first Wal-Mart store in 1962, and when he died thirty years later, his family's net worth was $25 billion.[22]

Industry experience also gave Howard Schultz, a New York executive for a housewares company, his breakthrough idea. In 1981, Schultz noticed that a small customer in Seattle—Starbucks Coffee, Tea and Spice—ordered more coffeemaker cone filters than Macy's and many other large customers. So he flew across the country to find out why. His meeting with the owner-operators of the original Starbucks Coffee Co. resulted in his becoming part-owner of the company. Schultz's vision for the company far surpassed that of its other owners. While they wanted Starbucks to remain small and local, Schultz saw potential for a national business that not only sold world-class-quality coffee beans but also offered customers a European coffee-bar experience. After attempting unsuccessfully to convince his partners to try his experiment, Schultz left Starbucks and started his own chain of coffee bars, which he called Il Giornale (after an Italian newspaper). Two years later, he bought out the original owners and reclaimed the name Starbucks.[23]

Ownership Options

As we've already seen, you can become a small business owner in one of three ways— by starting a new business, buying an existing one, or obtaining a franchise. Let's look more closely at the advantages and disadvantages of each option.

Starting from Scratch

The most common—and the riskiest—option is starting from scratch. This approach lets you start with a clean slate and allows you to build the business the way you want. You select the goods or services that you're going to offer, secure your location, and hire your employees, and then it's up to you to develop your customer base and build your reputation. This was the path taken by Andres Mason who figured out how to inject hysteria into the process of bargain hunting on the Web. The result is an overnight success story called Groupon.[24] Here is how Groupon (a blend of the words "group" and "coupon") works: A daily email is sent to over 6.5 million people in over 70 cities across the United States and Canada offering a deeply discounted deal to buy something or to do something in their city. If the person receiving the email likes the deal, he or she commits to buying it. But, here's the catch, if not enough people sign up for the deal, it is cancelled. Groupon makes money by keeping half of the revenue from the deal. The company offering the product or service gets exposure. But stay tuned: the "daily deals website isn't just unprofitable—it's bleeding hundreds of millions of dollars."[25] As with all start-ups cash is always a challenge.

Buying an Existing Business

If you decide to buy an existing business, some things will be easier. You'll already have a proven product, current customers, active suppliers, a known location, and trained employees. You'll also find it much easier to predict the business's future success.

There are, of course, a few bumps in this road to business ownership. First, it's hard to determine how much you should pay for a business. You can easily determine how much things like buildings and equipment are worth, but how much should you pay for the fact that the business already has steady customers?

In addition, a business, like a used car, might have performance problems that you can't detect without a test drive (an option, unfortunately, that you don't get when you're buying a business). Perhaps the current owners have disappointed customers; maybe the location isn't as good as it used to be. You might inherit employees that you wouldn't have hired yourself. Careful study called due diligence is necessary before going down this road.

Getting a Franchise

Lastly, you can buy a franchise. A franchisor (the company that sells the franchise) grants the franchisee (the buyer—you) the right to use a brand name and to sell its goods or services. Franchises market products in a variety of industries, including food, retail, hotels, travel, real estate, business services, cleaning services, and even weight-loss centres and wedding services. Table 5.1 lists the top ten franchises according to Entrepreneur magazine for 2018. Franchises apply to be on the list and are then assessed used Entrepreneur's five pillars (https://www.entrepreneur.com/franchise500/2018).

In Canada, 1 out of every 14 workers is directly or indirectly employed by the franchise industry and there are an estimated 1,300 franchise brands operating in Canada. Individual investments vary widely – from $10,000 to millions. KFC franchises, for example, require a total investment of $1.3 million to $2.5 million each. This fee includes the cost of the property, equipment, training, start-up costs, and the franchise fee—a one-time charge for the right to operate as a KFC outlet. McDonald's is in the same price range ($1 million to $2.3 million). SUBWAY sandwich shops offer a more affordable alternative, with expected total investment ranging from $116,000 to $263,000. Visit Canadian Franchising Opportunities[26] (http://www.canadafranchiseopportunities.ca/investment/) to see franchises by level of investment required.

Table 5.1

Ranking 2018	
1	McDonald's
2	7-Eleven Inc.
3	Dunkin'Donuts
4	The UPS Store
5	RE/MAX LLC
6	Sonic Drive-in
7	Great Clips
8	Taco Bell
9	Hardee's
10	Sport Clips

In addition to your initial investment, you'll have to pay two other fees on a monthly basis—a royalty fee (typically from 3 to 12 percent of sales) for continued support from the franchisor and the right to keep using the company's trade name, plus an advertising fee to cover your share of national and regional advertising. You'll also be expected to buy your products from the franchisor.[27]

But there are disadvantages. The cost of obtaining and running a franchise can be high, and you have to play by the franchisor's rules, even when you disagree with them. The franchisor maintains a great deal of control over its franchisees. For example, if you own a fast-food franchise, the franchise agreement will likely dictate the food and beverages you can sell; the methods used to store, prepare, and serve the food; and the prices you'll charge. In addition, the agreement will dictate what the premises will look like and how they'll be maintained. As with any business venture, you need to do your homework before investing in a franchise.

Why Some Businesses Fail and Where to Get Help

Why Do Some Businesses Fail?

If you've paid attention to the occupancy of shopping malls over a few years, you've noticed that retailers come and go with surprising frequency. The same thing happens with restaurants—indeed, with all kinds of businesses. By definition, starting a business—small or large—is risky, and though many businesses succeed, a large proportion of them don't. The most recent, official statistics for Canada, from 2013, report the following for the births and deaths of SMEs. Consult the table below or find the equivalent, text information from Industry Canada (https://www.ic.gc.ca/eic/site/061.nsf/eng/h_03018.html). Note: These statistics do not deal directly with entrepreneurs, but with small and medium enterprises or SMEs.

As disappointing as these statistics on business survival are, some industries are worse than others. If you want to stay in business for a long time, you might want to avoid some of these risky industries. Even though your friends think you make the best pizza in the world, this doesn't mean you can succeed as a pizza parlour owner. Opening a restaurant or a bar is one of the riskiest ventures (and, therefore, start-up funding is hard to get).

You might also want to avoid the transportation industry. Owning a taxi might appear lucrative until you find out what a taxi license costs. It obviously varies by city, but in New York City the price tag is upward of $400,000. No wonder taxi companies are resisting Uber and Lyft with all the energy they can muster. And setting up a shop to sell clothing can be challenging. Your view of "what's in" may be off, and one bad season can kill your business. The same is true for stores selling communication devices: every mall has one or more cell phone stores so the competition is steep, and business can be very slow.[28]

Businesses fail for any number of reasons, but many experts agree that the vast majority of failures result from some combination of the following problems:

- Bad business idea. Like any idea, a business idea can be flawed, either in the conception or in the execution. If you tried selling snow blowers in Hawaii, you could count on little competition, but you'd still be doomed to failure.
- Cash problems. Too many new businesses are underfunded. The owner borrows enough money to set up the business but doesn't have enough extra cash to operate during the start-up phase, when very little money is coming in but a lot is going out.
- Managerial inexperience or incompetence. Many new business owners have no experience in running a business; many have limited management skills. Maybe an owner knows how to make or market a product but doesn't know how to manage people. Maybe an owner can't attract and keep talented employees. Maybe an owner has poor leadership skills and isn't willing to plan ahead.
- Lack of customer focus. A major advantage of a small business is the ability to provide special attention to customers. But some small businesses fail to seize this advantage. Perhaps the owner doesn't anticipate customers' needs or keep up with changing markets or the customer-focused practices of competitors.
- Inability to handle growth. You'd think that a sales increase would be a good thing. Often it is, of course, but sometimes it can be a major problem. When a company grows, the owner's role changes. He or she needs to delegate work to others and build a business structure that can handle the increase in volume. Some owners don't make the transition and find themselves overwhelmed. Things don't get done, customers become unhappy, and expansion actually damages the company.

Some Canadian Considerations

This chapter provided some solid, foundational knowledge on entrepreneurship. But take a few moments to see who might be left behind in the growth of entrepreneurship.

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Key Takeaways / Important Terms and Concepts

1. An entrepreneur is someone who identifies a business opportunity and assumes the risk of creating and running a business to take advantage of it.
2. The three characteristics of entrepreneurial activity are innovating, running a business, and risk taking.
3. A small business is independently owned and operated, exerts little influence in its industry, and has fewer than one hundred employees.
4. An industry is a group of companies that compete with one another to sell similar products. There are two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.
5. Once you decide to start a business, you'll need to create a business plan—a document that identifies the goals of your proposed business and explains how it will achieve them.

The Lean Startup

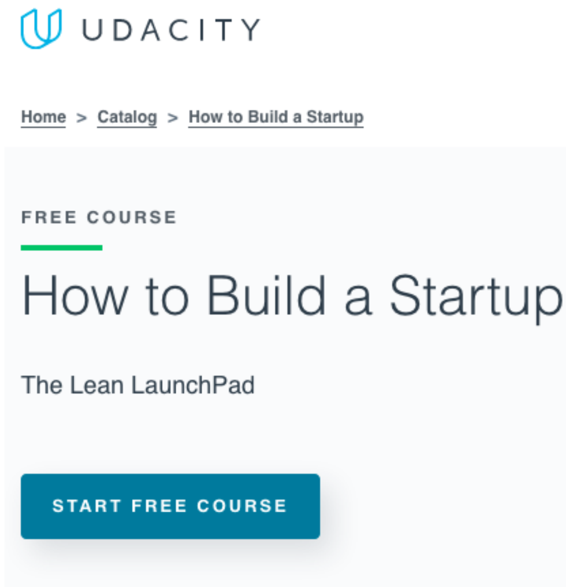
Lean startup is a methodology for developing businesses and products that aims to shorten product development cycles and rapidly discover if a proposed business model is viable; this is achieved by adopting a combination of business-hypothesis-driven experimentation, iterative product releases, and validated learning. Central to the lean startup methodology is the assumption that when startup companies invest their time into iteratively building products or services to meet the needs of early customers, the company can reduce market risks and sidestep the need for large amounts of initial project funding and expensive product launches and failures.[29]

The **Business Model Canvas** is a strategic management template invented by Alexander Osterwalder around 2008 for developing new business models or documenting existing ones. It is a visual chart with elements describing a firm's value proposition, infrastructure, customers, and finances. It assists firms in aligning their activities by illustrating potential trade-offs. The template consists of nine blocks: activities, partners, resources, value proposition, customers, customer channels, customer relationships, costs and revenue. Startups use the template (and/or other templates described below) to formulate hypotheses and change their business model based on the success or failure of tested hypotheses.[30]

Steve Blank (born 1953) is a Silicon Valley entrepreneur based in Pescadero, California. Blank is recognized for developing the customer development method that launched the lean startup movement, a methodology which recognized that startups are not smaller versions of large companies, but require their own set of processes and tools to be successful. His Lean Launchpad class (taught as the National Science Foundation Innovation Corps, or I-Corps has become the standard for commercialization for all federal research.[31]

How to Build a Start Up

As part of this course you will complete the **free online course How to Build a StartUp** (https://www.udacity.com/course/how-to-build-a-startup--ep245) available from a non-accredited but widely recognized online university – **udacity.com**. The self paced udacity course includes nine modules and should be taken over the final four weeks of the NSCC BUSI 1015 course. The udacity course will help with the final capstone assignment for BUSI 1015 where, over four weeks, you will develop a Business Model Canvas.



6. Ethics and Social Responsibility

Learning Objectives

By the end of the chapter, you should be able to:

1. Define business ethics and explain what it means to act ethically in business.
2. Explain why we study business ethics.
3. Identify ethical issues that you might face in business, such as insider trading, conflicts of interest, and bribery, and explain rationalizations for unethical behaviour.
4. Identify steps you can take to maintain your honesty and integrity in a business environment.
5. Define corporate social responsibility and explain how organizations are responsible to their stakeholders, including owners, employees, customers, and the community.
6. Discuss how you can identify an ethical organization, and how organizations can prevent behaviour like sexual harassment.
7. Recognize how to avoid an ethical lapse, and why you should not rationalize when making decisions.

Show What You Know

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Canada's Leader: Passing or Failing the "Smell Test"?

Ethics is not always black and white; the ethical decision is not always obvious to all. Even leaders can fail to act ethically all the time. Recent decisions impacted two leaders.

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CBC News's reporter, E. Thompson, filed the following story on December 21, 2017. It provides a detailed account of the ethical issues surrounding Prime Minister Trudeau's trip to Aga Khan's private island.

CBC NEWS – Aga Khan could face lobbying probe for Trudeau trip[1]

Democracy Watch (http://democracywatch.ca/) files complaint, saying Bahamas vacation violated lobbying law.

The Aga Khan could face an investigation into allegations he violated Canada's Lobbying Act by giving Prime Minister Justin Trudeau and his family free vacations on his private island in the Bahamas at the same time as he was discussing funding for projects.

Democracy Watch sent a letter to the Commissioner of Lobbying late Wednesday, urging her to investigate whether Prince Shah Karim Al Hussaini Aga Khan IV "violated the Lobbyists Code by giving Prime Minister Trudeau and Liberal MP Seamus O'Regan the gifts of trips to his island home".

In the letter, Democracy Watch co-founder Duff Conacher says the Aga Khan's actions have put Trudeau and O'Regan in a conflict of interest. It is also against the law to give a public office holder a gift that could create a sense of obligation.

"Your position must be that anyone working for or associated with a company that is registered to lobby a public office holder who gives to or does anything for that office holder… that is more than an average voter does… puts that office holder in an apparent conflict of interest," he wrote.

The Aga Khan is the spiritual leader of millions of Ismaili Muslims and is listed as a member of the board of directors of the Aga Khan Foundation Canada. The foundation, which has received millions of dollars in federal government development aid over the years, is registered to lobby several federal government departments including the Prime Minister's Office, although the Aga Khan is not listed among those registered to lobby on its behalf.

A search of the lobbyist registry shows the foundation has filed 132 reports since 2011 outlining its meetings with government decision makers. However, none of those reports list any meetings with Trudeau.

Representatives of the Aga Khan Foundation of Canada contacted by CBC News have yet to comment.

The call for a lobbying investigation comes in the wake of a scathing report by Ethics Commissioner Mary Dawson on Wednesday.

Dawson found that Trudeau violated four sections of the Conflict of Interest Act when he accepted a vacation on the island in the Bahamas and a ride in the Aga Khan's personal helicopter.

While Trudeau and his family got a tropical vacation, Canadian taxpayers got a bill for more than $215,000 in transportation and staffing costs — far more than the government initially disclosed to Parliament.

Dawson also revealed that Trudeau's trip during last year's Christmas holidays was one of three that Trudeau or members of his family had made to the island. Dawson disclosed that Sophie Grégoire-Trudeau stayed on the island in March 2016 with a friend and their children.

Neither the Aga Khan, nor any member of his family, was on the island during their stay.

Dawson said the Aga Khan was on the island during the Trudeaus' Christmas-time visit last year as was a "senior American official of a previous administration," who she did not name.

In her report, Dawson describes the relationship between Trudeau and the Aga Khan, the times they met and the questions they discussed.

Among them was a bilateral meeting on May 17, 2016 that was arranged by “representatives” of the Aga Khan. After a 15-minute chat between the two men about “personal matters, the Ismaili community in general and geopolitics,” they were joined by three of the Aga Khan’s representatives, Heritage Minister Mélanie Joly, staff members from the Prime Minister’s Office and senior officials of the Privy Council Office.

Dawson’s report says the government had found a funding mechanism to allow it to contribute to the Global Centre for Pluralism’s endowment fund and Trudeau reaffirmed the government’s $15 million commitment during the meeting.

The Aga Khan’s pitch for government funding for a $200 million riverfront renewal plan in Ottawa was also discussed.

Dawson ruled that Trudeau should have recused himself from two discussions in May 2016 involving the $15 million grant.

“Two months prior to the May 2016 occasions, Mr. Trudeau’s family accepted a gift from the Aga Khan that might reasonably be seen to have been given to influence Mr. Trudeau in the exercise of an official power, duty or function as Prime Minister,” she wrote.

“For this reason, the discussions with the Privy Council Office and later with the Aga Khan about the outstanding $15 million grant to the endowment fund provided an opportunity to improperly further the private interests of the Global Centre for Pluralism.”

While the Aga Khan is not paid to lobby government (one of the criteria under the law) Conacher said he believes the Aga Khan violated the lobbying rules. Otherwise, it would create a giant loophole, he said.

“Every single corporation, business, union, non-profit organization would start using board members to give gifts to politicians if this loophole were opened up by the lobbying commissioner.”

Conacher is also calling for outgoing lobbying commissioner Karen Shepherd and incoming lobbying commissioner Nancy Bélanger to recuse themselves from ruling on the investigation because of the way Shepherd’s contract was renewed and the way Bélanger was chosen in “a secretive, PMO-controlled process.”

Manon Dion, spokeswoman for the lobbying commissioner’s office, said she cannot reveal whether they are already looking into the issue.

Point to Ponder

Could the Prime Minister and family have taken an ethical version of this vacation? If yes, how? If not, why not?

The Prime Minister’s Response: http://www.cbc.ca/news/politics/trudeau-ethics-aga-khan-1.4458220

The Ethics Commissioner’s Report: https://www.documentcloud.org/documents/4334047-The-Trudeau-Report.html

Moving Ethics To the Business World

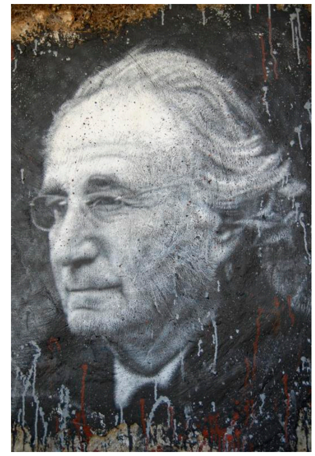

Figure 6.1: Bernie Madoff by thierry ehrmann licensed CC BY | flickr

Perhaps you have heard of Bernie Madoff, founder of Bernard L. Madoff Investment Securities and former chairman of the NASDAQ stock exchange.[2] Madoff is alleged to have run a giant Ponzi scheme[3] that cheated investors of up to $65 billion. His wrongdoings won him a spot at the top of Time Magazine's Top 10 Crooked CEOs. According to the SEC charges, Madoff convinced investors to give him large sums of money. In return, he gave them an impressive 8 percent to 12 percent return a year. But Madoff never really invested their money. Instead, he kept it for himself. He got funds to pay the first investors their return (or their money back if they asked for it) by bringing in new investors. Everything was going smoothly until the fall of 2008, when the stock market plummeted and many of his investors asked for their money. As he no longer had it, the game was over and he had to admit that the whole thing was just one big lie. Thousands of investors, including many of his wealthy friends, not-so-rich retirees who trusted him with their life savings, and charitable foundations, were financially ruined. Those harmed by Madoff either directly or indirectly were likely pleased when he was sentenced to jail for one-hundred and fifty years.

What is Business Ethics?

The Idea of Business Ethics

It's in the best interest of a company to operate ethically. Trustworthy companies are better at attracting and keeping customers, talented employees, and capital. Those tainted by questionable ethics suffer from dwindling customer bases, employee turnover, and investor mistrust.

Let's begin this section by addressing this question: What can individuals, organizations, and government agencies do to foster an environment of ethical behaviour in business? First, of course, we need to define the term.

What Is Ethics?

You probably already know what it means to be ethical: to know right from wrong and to know when you're practising one instead of the other. Business ethics is the application of ethical behaviour in a business context. Acting ethically in business means more than simply obeying applicable laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your company, its owners, and its workers. If you're in business you obviously need a strong sense of what's right and wrong. You need the personal conviction to do what's right, even if it means doing something that's difficult or personally disadvantageous.

Why Study Ethics?

Ideally, prison terms, heavy fines, and civil suits would discourage corporate misconduct, but, unfortunately, many experts suspect that this assumption is a bit optimistic. Whatever the condition of the ethical environment in the near future, one thing seems clear: the next generation entering business—which includes most of you—will find a world much different than the one that waited for the previous generation. Recent history tells us in no uncertain terms that today's business students, many of whom are tomorrow's business leaders, need a much sharper understanding of the difference between what is and isn't ethically acceptable. As a business student, one of your key tasks is learning how to recognize and deal with the ethical challenges that will confront you. Asked what he looked for in a new hire, Warren Buffet, the world's most successful investor, replied: "I look for three things. The first is personal integrity, the second is intelligence, and the third is a high energy level." He paused and then added: "But if you don't have the first, the second two don't matter".[4]

Identifying Ethical Issues and Dilemmas

Ethical issues are the difficult social questions that involve some level of controversy over what is the right thing to do. Environmental protection is an example of a commonly discussed ethical issue, because there can be trade-offs between environmental and economic factors.

Tips to maintain honesty and integrity

- Follow your own code of personal conduct; act according to your own convictions rather than doing what's convenient (or profitable) at the time.
- While at work, focus on your job, not on non-work related activities, such as emails and personal phone calls.
- Don't appropriate office supplies or products or other company resources for your own use.
- Be honest with customer, management, coworkers, competitors, and the public.
- Remember that it's the small seemingly trivial, day-to-day activities and gestures that build your character.

Make no mistake about it: when you enter the business world, you'll find yourself in situations in which you'll have to choose the appropriate behaviour. How, for example, would you answer questions like the following?

1. Is it OK to accept a pair of sports tickets from a supplier?
2. Can I buy office supplies from my brother-in-law?
3. Is it appropriate to donate company funds to a local charity?
4. If I find out that a friend is about to be fired, can I warn her?

Obviously, the types of situations are numerous and varied. Fortunately, we can break them down into a few basic categories: issues of honesty and integrity, conflicts of interest and loyalty, bribes versus gifts, and whistle-blowing. Let's look a little more closely at each of these categories.

Issues of Honesty and Integrity

Master investor Warren Buffet once told a group of business students the following: "I cannot tell you that honesty is the best policy. I can't tell you that if you behave with perfect honesty and integrity somebody somewhere won't behave the other way and make more money. But honesty is a good policy. You'll do fine, you'll sleep well at night and you'll feel good about the example you are setting for your coworkers and the other people who care about you".[5]

If you work for a company that settles for its employees' merely obeying the law and following a few internal regulations, you might think about moving on. If you're being asked to deceive customers about the quality or value of your product, you're in an ethically unhealthy environment.

Think about this story:

"A chef put two frogs in a pot of warm soup water. The first frog smelled the onions, recognized the danger, and immediately jumped out. The second frog hesitated: The water felt good, and he decided to stay and relax for a minute. After all, he could always jump out when things got too hot (so to speak). As the water got hotter, however, the frog adapted to it, hardly noticing the change. Before long, of course, he was the main ingredient in frog-leg soup."[6]

So, what's the moral of the story? Don't sit around in an ethically toxic environment and lose your integrity a little at a time; get out before the water gets too hot and your options have evaporated.

Conflicts of Interest

Conflicts of interest occur when individuals must choose between taking actions that promote their personal interests over the interests of others or taking actions that don't. A conflict can exist, for example, when an employee's own interests interfere with, or have the potential to interfere with, the best interests of the company's stakeholders (management, customers, and owners). Let's say that you work for a company with a contract to cater events at your college and that your uncle owns a local bakery. Obviously, this situation could create a conflict of interest (or at least give the appearance of one—which is a problem in itself). When you're called on to furnish desserts for a luncheon, you might be tempted to send some business your uncle's way even if it's not in the best interest of your employer. What should you do? You should disclose the connection to your boss, who can then arrange things so that your personal interests don't conflict with the company's.

The same principle holds that an employee shouldn't use private information about an employer for personal financial benefit. Say that you learn from a coworker at your pharmaceutical company that one of its most profitable drugs will be pulled off the market because of dangerous side effects. The recall will severely hurt the company's financial performance and cause its stock price to plummet. Before the news becomes public, you sell all the stock you own in the company. What you've done is called insider trading – acting on information that is not available to the general public, either by trading on it or providing it to others who trade on it. Insider trading is illegal, and you could go to jail for it.

Conflicts of Loyalty

You may one day find yourself in a bind between being loyal either to your employer or to a friend or family member. Perhaps you just learned that a coworker, a friend of yours, is about to be downsized out of his job. You also happen to know that he and his wife are getting ready to make a deposit on a house near the company headquarters. From a work standpoint, you know that you shouldn't divulge the information. From a friendship standpoint, though, you feel it's your duty to tell your friend. Wouldn't he tell you if the situation were reversed? So what do you do? As tempting as it is to be loyal to your friend, you shouldn't tell. As an employee, your primary responsibility is to your employer. You might be able to soften your dilemma by convincing a manager with the appropriate authority to tell your friend the bad news before he puts down his deposit.

Bribes Versus Gifts

It's not uncommon in business to give and receive small gifts of appreciation, but when is a gift unacceptable? When is it really a bribe?

There's often a fine line between a gift and a bribe. The following information may help in drawing it, because it raises key issues in determining how a gesture should be interpreted: the cost of the item, the timing of the gift, the type of gift, and the connection between the giver and the receiver. If you're on the receiving end, it's a good idea to refuse any item that's overly generous or given for the purpose of influencing a decision. Because accepting even small gifts may violate company rules, always check on company policy.

Read through Figure 6.2, Bell Canada's *Code of Business Conduct* detailing its recommendations for gifts. If you cannot access Figure 6.2, find it on page 10 of the document (http://www.bce.ca/governance/code-of-business-conduct/2017-august-code-of-business-conduct.pdf).

Code of Business Conduct

2.3 Loans, Gifts and Entertainment

2.3.1 Loans from Bell

We do not accept, whether directly or indirectly, any loan or guarantee of obligations from Bell that are for our personal benefit.

2.3.2 Business Gifts & Entertainment

Do not solicit, accept or give gifts, gratuities, favours or unusual hospitality from or to suppliers or customers, which may compromise - or appear to compromise - our ability to make fair, objective, business decisions or may unfairly influence a business interaction.

Do not solicit or encourage gifts, hospitality, entertainment or any other thing for personal use.

Do not accept gifts having a monetary value; for example, gift certificates, cash, services, discounts or loans.

These guidelines do not change during traditional gift giving season.

We recognize, however, that building relationships with customers and suppliers is an integral part of doing business.

You may offer and accept reasonable hospitality in certain cases. You should consult your manager or contact the Business Conduct Help Line when in doubt about the appropriateness of a particular situation.

You may participate in unsolicited business entertainment depending on the function or services you perform for Bell and if the entertainment is clearly intended to facilitate business goals. If for example, tickets to a sporting or cultural event are offered, then the person offering the tickets should plan to attend the event as well.

You may sponsor events/activities for customers or potential customers where the purpose is to strengthen business relationships; however it is your responsibility to know and be sensitive to the customer's own code of conduct on these issues. Solicitation of modest gifts or prizes for Bell sponsored events which provide clear benefits to the sponsor and/or charitable organization is permitted upon approval by your manager.

You may accept unsolicited, nominal value hospitality, gifts or mementos that are customary or business related.

You may accept business entertainment in the form of meals as long as it is modest, infrequent, and as far as possible on a reciprocal basis.

Factors which you and your manager should consider when assessing the proper course of action include:

- Is Bell potentially involved in a major procurement activity with the company offering the gift or entertainment?
- Would the gift or entertainment be considered appropriate or customary, taking into account the nature of the function or services you perform for Bell?
- Would it be perceived as insulting or damaging to the business relationship to return the gift or decline the hospitality?
- Can the gift or hospitality be applied to benefit all team members rather than certain individuals?

Figure 6.2: Bell Code of Business Conduct[7].

Whistleblowing

Whistleblowing was defined in 1972 by Ralph Nader as *"an act of a man or a woman who, believing in the public interest overrides the interest of the organization he serves, publicly blows the whistle if the organization is involved in corrupt, illegal, fraudulent or harmful activity"*.

While there are increasing incentives from governments and regulators for whistleblowers to go public about corporate misconduct, protections for whistleblowers are still very limited. Few Canadian laws pertain directly to whistleblowing and therefore whistleblowers are mostly unprotected by statute.

There is, however, a patchwork of protection provisions for whistleblowers under the Canadian *Criminal Code*, *Public Servants Disclosure Protection Act* (*PSDPA*), the *Public Service of Ontario Act, 2006* as well as the *Securities Act*.

Section 425.1 (http://laws-lois.justice.gc.ca/eng/acts/C-46/page-90.html#h-113) of the *Criminal Code*, for example, states that employers may not threaten or take disciplinary action against, demote or terminate an employee in order to deter her/him from reporting information regarding an offence s/he believes has or is being committed by her/his employer to the relevant law enforcement authorities.

An employer cannot threaten an employee with negative repercussions to deter them from contacting law enforcement with information about the employer's offence. Punishment for employers who make such threats or reprisals can include up to five years imprisonment and/or fines.

In early 2018, a Canadian whistleblower received worldwide recognition for disclosing the amount and kinds of data harvested by Cambridge Analytica through personal Facebook accounts. However, there are other, prominent Canadian whistleblowers (https://www.cfe.ryerson.ca/key-resources/lists/prominent-canadian-whistleblowers).

Corporate Social Responsibility

Corporate social responsibility (CSR) refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economical, ethical, and social decisions. Remember that we previously define stakeholders as those with a legitimate interest in the success or failure of the business and the policies it adopts. The term social responsibility refers to the approach that an organization takes in balancing its responsibilities toward their various stakeholders.

What motivates companies to be "socially responsible"? We hope it's because they want to do the right thing, and for many companies , "doing the right thing" is a key motivator. The fact is, it's often hard to figure out what the "right thing" is: what's "right" for one group of stakeholders isn't necessarily "right" for another. One thing, however, is certain: companies today are held to higher standards than ever before. Consumers and other groups consider not only the quality and price of a company's products but also its character. If too many groups see a company as a poor corporate citizen, it will have a harder time attracting qualified employees, finding investors, and selling its products. Good corporate citizens, by contrast, are more successful in all these areas.

Another Lens[8]

Carroll's Pyramid is a well-respected resource for situating corporate social responsibility. Another view of corporate social responsibility is from the perspective of a company's relationships with its stakeholders. In this model, the focus is on managers—not owners—as the principals involved in these relationships. Owners are the stakeholders who invest risk capital in the firm in expectation of a financial return. Other stakeholders include employees, suppliers, and the communities in which the firm does business. Proponents of this model hold that customers, who provide the firm with revenue, have a special claim on managers' attention. The arrows in Figure 6.3 indicate the two-way nature of corporation-stakeholder relationships. All stakeholders have some claim on the firm's resources and returns, and management's job is to make decisions that balance these claims.[9]

Figure 6.3: Management's relationship with stakeholders

Let's look at some of the ways in which companies can be "socially responsible" in considering the claims of various stakeholders.

Owners

Owners invest money in companies. In return, the people who run a company have a responsibility to increase the value of owners' investments through profitable operations. Managers also have a responsibility to provide owners (as well as other stakeholders having financial interests, such as creditors and suppliers) with accurate, reliable information about the performance of the business. Clearly, this is one of the areas in which WorldCom managers fell down on the job. Upper-level management purposely deceived shareholders by presenting them with fraudulent financial statements

Managers

Managers have what is known as a fiduciary responsibility to owners: they're responsible for safeguarding the company's assets and handling its funds in a trustworthy manner. Yet managers experience what is called the agency problem; a situation in which their best interests do not align with those of the owners who employ them. To enforce managers' fiduciary responsibilities for a firm's financial statements and accounting records, Ontario's Keeping the Promise for a Strong Economy Act (Budget Measures) 2002, also known as Bill 198, (Canadian equivalent to Sarbanes-Oxley Act of 2002 in the United States) requires CEOs and CFOs to attest to their accuracy. The law also imposes penalties on corporate officers, auditors, board members, and any others who commit fraud. You'll learn more about this law in your accounting and business law courses.

Employees

Companies are responsible for providing employees with safe, healthy places to work—as well as environments that are free from sexual harassment and all types of discrimination. They should also offer appropriate wages and benefits. In the following sections, we'll take a closer look at these areas of corporate responsibility.

Wages and Benefits

At the very least, employers must obey laws governing minimum wage and overtime pay. A minimum wage is set by the provincial government. As of January 1, 2018, the Ontario rate is $14.00 with another increase to $15.00 set for January 1, 2019. By law, employers must also provide certain benefits—Canadian Pension Plan (CPP -retirement funds), unemployment insurance (protects against loss of income in case of job loss), and depending on the industry, workers' compensation (covers lost wages and medical costs in case of on-the-job injury). Most large companies pay most of their workers more than minimum wage and offer broader benefits, including medical, dental, and vision care, as well as savings programs, in order to compete for talent.

Safety and Health

Though it seems obvious that companies should guard workers' safety and health, some simply don't. For over four decades, for example, executives at Johns Manville suppressed evidence that one of its products, asbestos, was responsible for the deadly lung disease developed by many of its workers.[10] The company concealed chest X- rays from stricken workers, and executives decided that it was simply cheaper to pay workers' compensation claims than to create a safer work environment. A New Jersey court was quite blunt in its judgment: Johns Manville, it held, had made a deliberate, cold-blooded decision to do nothing to protect at-risk workers, in blatant disregard of their rights.[11]

In The Globe and Mail's 2017 article, "Statistics Canada looks to close data gap on workplace death, injuries" examines the different, Canadian landscape on safety and health.

Currently, responsibility for workers' compensation and occupational health and safety issues falls largely to provinces or territories – and each jurisdiction has different approaches in capturing data. As a result, there's an "uneven landscape" of health and safety research capacity, said Barbara Neis, co-founder and senior research associate at the SafetyNet Centre for Occupational Health and Safety Research at Memorial University.

The last time Statistics Canada produced a national analysis was in 1996.

Responsibility for fatality and injury counts, which are based on accepted workers' compensation claims, shifted over to the Association of Workers' Compensation Boards at that time. Detailed data must be purchased, and researchers say these counts don't represent the whole workforce, partly because not all sectors or types of workers are included in the workers' compensation system.

Available workers' compensation numbers show about 350 Canadians die each year from an on-the-job injury at work. If longer-term work-related illnesses (such as mesothelioma from asbestos exposures, or lung cancers from silica dust) are factored in, this number climbs to about 1,000 deaths a year.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=52#h5p-8

Customers

The purpose of any business is to satisfy customers, who reward businesses by buying their products. Sellers are also responsible—both ethically and legally—for treating customers fairly. This means customers have:

1. The right to safe products. A company should sell no product that it suspects of being unsafe for buyers. Thus, producers have an obligation to safety-test products before releasing them for public consumption. The automobile industry, for example, conducts extensive safety testing before introducing new models (though recalls remain common).
2. The right to be informed about a product. Sellers should furnish consumers with the product information that they need to make an informed purchase decision. That's why pillows have labels identifying the materials used to make them, for instance.
3. The right to choose what to buy. Consumers have a right to decide which products to purchase, and sellers should let them know what their options are. Pharmacists, for example, should tell patients when a prescription can be filled with a cheaper brand-name or generic drug. Telephone companies should explain alternative calling plans.
4. The right to be heard. Companies must tell customers how to contact them with complaints or concerns. They should also listen and respond.

Companies share the responsibility for the legal and ethical treatment of consumers with several government agencies.

In Canada, consumer complaints are regulated by different levels of government, as well as non-government organizations. Finding the right place to direct your complaint is not always easy, but understanding your rights as a consumer is an important part of the complaint filing process.

Provincial and territorial consumer protection legislation

Many consumer complaints fall under provincial and territorial jurisdiction, including issues related to:

- buying goods and services;
- contracts;
- the purchase, maintenance or repair of motor vehicles;
- credit reporting agencies and the practices of collection agencies.

Federal consumer protection legislation

The Government of Canada has an important role in consumer awareness and protection.

Federal agencies and departments are responsible for enforcing legislation related to various issues, including:

- consumer product safety;
- food safety;
- consumer product packaging and labelling;
- anti-competitive practices, such as price fixing and misleading advertising;
- privacy complaints.

Reproduced from the Federal Office of Consumer Affairs
Government of Canada. (2018). Consumer protection legislation in Canada. Office of Consumer Affairs. https://www.ic.gc.ca/eic/site/Oca-bc.nsf/eng/ca02965.html?Open=1&

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=52#h5p-9

Communities

For obvious reasons, most communities see getting a new business as an asset and view losing one—especially a large employer—as a detriment. After all, the economic impact of business activities on local communities is substantial: they provide jobs, pay taxes, and support local education, health, and recreation programs. Both big and small businesses donate funds to community projects, encourage employees to volunteer their time, and donate equipment and products for a variety of activities. Larger companies can make greater financial contributions. Let's start by taking a quick look at the philanthropic activities of a few U.S. corporations.

Philanthropy

Many large corporations support various charities, an activity called philanthropy. Some donate a percentage of sales or profits to worthwhile causes. Retailer Target, for example, donates 5 percent of its profits—about $2 million per week—to schools, neighborhoods, and local projects across the country; its store-based grants underwrite programs in early childhood education, the arts, and family-violence prevention.[12] The late actor Paul Newman donated 100 percent of the profits from "Newman's Own" foods (salad dressing, pasta sauce, popcorn, and other products sold in eight countries). His company continues his legacy of donating all profits and distributing them to thousands of organizations, including the Hole in the Wall Gang camps for seriously ill children.[13]

Across the border, Canadian companies also show their philanthropic side. Tim Horton's Children's Foundation sends 19,000 kids to camp each summer, who would otherwise not have the resources to attend.[14] Its Timbits Minor Sports Program supports the participation of 300 000 kids in their pursuit of hockey, soccer, lacrosse, softball, baseball, and ringette[15]. In 2017, Loblaw Companies and its President's Choice Children's Charity pledged $150 million over the next decade to address childhood hunger in Canada.[16] These are just two examples of Canadian companies giving back at the local and national levels.

Ethical Organizations

How Can You Recognize an Ethical Organization?

One goal of anyone engaged in business should be to foster ethical behaviour in the organizational environment. How do we know when an organization is behaving ethically? Most lists of ethical organizational activities include the following criteria:

- Treating employees, customers, investors, and the public fairly
- Holding every member personally accountable for his or her action
- Communicating core values and principles to all members
- Demanding and rewarding integrity from all members in all situations[17]

Employees at companies that consistently make Business Ethics magazine's list of the "100 Best Corporate Citizens" regard the items on the previous list as business as usual in the workplace. Companies at the top of the 2016 list include Microsoft, Hasbro, Ecolab, Bristol-Myers-Squibb, and Lockheed Martin.[18]

By contrast, employees with the following attitudes tend to suspect that their employers aren't as ethical as they should be:

- They consistently feel uneasy about the work they do.
- They object to the way they're treated.
- They're uncomfortable about the way coworkers are treated.
- They question the appropriateness of management directives and policies.[19]

Sexual Harassment

Sexual harassment occurs when an employee makes "unwelcome sexual advances, requests for sexual favours, and other verbal or physical conduct of a sexual nature" to another employee. It's also considered sexual harassment when "submission to or rejection of this conduct explicitly or implicitly affects an individual's employment, unreasonably interferes with an individual's work performance or creates an intimidating, hostile or offensive work environment."[20]

Sexual harassment rocketed to the top of news reports and social media when on October 5, 2017, *The New York Times* broke the story of Harvey Weinstein's decades of harassment in Hollywood. In March of 2018, CBC News collated the allegations of sexual harassment against prominent Canadians (http://www.cbc.ca/radio/day6/here-s-a-list-of-well-known-men-in-canada-called-out-for-alleged-sexual-misconduct-since-weinstein-1.4428132). The list, including only those allegations reported by CBC, highlight the prevalence of this issue.

To prevent sexual harassment—or at least minimize its likelihood—a company should adopt a formal anti-harassment policy describing prohibited conduct, asserting its objections to the behaviour, and detailing penalties for violating the policy. Employers also have an obligation to investigate harassment complaints. Failure to enforce anti-harassment policies can be very costly. At the end of 2017, 353 women had submitted and finalized sexual harassment, discrimination or intimidation claims against the RCMP with as many as another 650 expected to file. To settle these claims, the government of Canada has set aside $100 million.

Workforce Diversity | Inclusive Workplaces

In addition to complying with equal employment opportunity laws, many companies make special efforts to recruit employees who are underrepresented in the workforce according to sex, race, or some other characteristic. In helping to build more inclusive workforces, such initiatives contribute to competitive advantage for two reasons:

1. People from diverse backgrounds bring new talents and fresh perspectives to an organization, typically enhancing creativity in the development of new products.
2. By more accurately reflecting the demographics of the marketplace, a diverse workforce improves a company's ability to serve an ethnically diverse population.

> Each year The Globe and Mail, reports on Canada's Top 100 Employers (http://www.canadastop100.com/diversity/). Peruse the list of industry winners and follow through to highlights detailing why the company topped the list.
>
> Please note the selection process:
>
> To determine this year's winners of the *Canada's Best Diversity Employers* competition, Mediacorp editors reviewed diversity and inclusiveness initiatives at employers that applied for the Canada's Top 100 Employers project. From this applicant pool, a smaller short-list of employers with noteworthy and unique diversity initiatives was developed. The short-listed candidates' programs were compared to those of other employers in the same field. The finalists chosen represent the diversity leaders in their industry and region of Canada.

The Individual Approach to Ethics

How can you make sure that you do the right thing in the business world? How should you respond to the kinds of challenges that you'll be facing? Because your actions in the business world will be strongly influenced by your moral character, let's begin by assessing your current moral condition. Which of the following best applies to you (select one)?

1. I'm always ethical.
2. I'm mostly ethical.
3. I'm somewhat ethical.
4. I'm seldom ethical.
5. I'm never ethical.

Now that you've placed yourself in one of these categories, here are some general observations. Few people put themselves below the second category. Most of us are ethical most of the time, and most people assign themselves to category number two— "I'm mostly ethical." Why don't more people claim that they're always ethical?

Apparently, most people realize that being ethical all the time takes a great deal of moral energy. If you placed yourself in category number two, ask yourself this question: How can I change my behaviour so that I can move up a notch? The answer to this question may be simple. Just ask yourself an easier question: How would I like to be treated in a given situation?[21]

Unfortunately, practising this philosophy might be easier in your personal life than in the business world. Ethical challenges arise in business because companies, especially large ones, have multiple stakeholders who sometimes make competing demands. Making decisions that affect multiple stakeholders isn't easy even for seasoned managers; and for new entrants to the business world, the task can be extremely daunting. You can, however, get a head start in learning how to make ethical decisions by looking at two types of challenges that you'll encounter in the business world: ethical dilemmas and ethical decisions.

Case Study: How a Bottle Cap Restored a Reputation (Temporarily)

Addressing Ethical Dilemmas

An ethical dilemma is a morally problematic situation: you must choose between two or more acceptable but often opposing alternatives that are important to different groups. Experts often frame this type of situation as a "right-versus-right" decision. It's the sort of decision that Johnson & Johnson (known as J&J) CEO James Burke had to make in 1982.[22] On September 30, twelve-year-old Mary Kellerman of Chicago died after her parents gave her Extra-Strength Tylenol. That same morning, twenty-seven-year-old Adam Janus, also of Chicago, died after taking Tylenol for minor chest pain. That night, when family members came to console his parents, Adam's brother and his wife took Tylenol from the same bottle and died within forty-eight hours. Over the next two weeks, four more people in Chicago died after taking Tylenol. The actual connection between Tylenol and the series of deaths wasn't made until an off-duty fireman realized from news reports that every victim had taken Tylenol. As consumers panicked, J&J pulled Tylenol off Chicago-area retail shelves. Researchers discovered Tylenol capsules containing large amounts of deadly cyanide. Because the poisoned bottles came from batches originating at different J&J plants, investigators determined that the tampering had occurred after the product had been shipped.[23]

So J&J wasn't at fault. But CEO Burke was still faced with an extremely serious dilemma: Was it possible to respond to the tampering cases without destroying the reputation of a highly profitable brand?

Burke had two options:

1. He could recall only the lots of Extra-Strength Tylenol that were found to be tainted with cyanide. In 1991, Perrier executives recalled only tainted product when they discovered that cases of their bottled water had been poisoned with benzine. This option favoured J&J financially but possibly put more people at risk.
2. Burke could order a nationwide recall—of all bottles of Extra-Strength Tylenol. This option would reverse the priority of the stakeholders, putting the safety of the public above stakeholders' financial interests.

Burke opted to recall all 31 million bottles of Extra-Strength Tylenol on the market. The cost to J&J was $100 million, but public reaction was quite positive. Less than six weeks after the crisis began, Tylenol capsules were reintroduced in new tamper-resistant bottles, and by responding quickly and appropriately, J&J was eventually able to restore the Tylenol brand to its previous market position. When Burke was applauded for moral courage, he replied that he'd simply adhered to the long-standing J&J credo that put the interests of customers above those of other stakeholders. His only regret was that the perpetrator was never caught.[24]

Figure 6.4: Source: CNBC

If you're wondering what your thought process should be if you're confronted with an ethical dilemma, you might wish to remember the mental steps listed here—which happen to be the steps that James Burke took in addressing the Tylenol crisis:

1. Define the problem: How to respond to the tampering case without destroying the reputation of the Tylenol brand.
2. Identify feasible options: (1) Recall only the lots of Tylenol that were found to be tainted or (2) order a nationwide recall of all bottles of Extra-Strength Tylenol.
3. Assess the effect of each option on stakeholders: Option 1 (recalling only the tainted lots of Tylenol) is cheaper but puts more people at risk. Option 2 (recalling all bottles of Extra-Strength Tylenol) puts the safety of the public above stakeholders' financial interests.
4. Establish criteria for determining the most appropriate action: Adhere to the J&J credo, which puts the interests of customers above those of other stakeholders.
5. Select the best option based on the established criteria: In 1982, Option 2 was selected, and a nationwide recall of all bottles of Extra-Strength Tylenol was conducted.

Making Ethical Decisions

In contrast to the "right-versus-right" problem posed by an ethical dilemma, an ethical decision entails a "right-versus-wrong" decision—one in which there is clearly a right (ethical) choice and a wrong (unethical or illegal) choice. When you make a decision that's unmistakably unethical or illegal, you've committed an ethical lapse. If you're presented with this type of choice, asking yourself the following questions and increase your odds of making an ethical decision.

1. **Is the action illegal?**
2. **Is it unfair to some stakeholders?**
3. **If I do it, will I feel badly about it?**
4. **Will I be ashamed to tell my family friends, coworkers, or boss?**
5. **Will I be embarrassed if my action is written up in the newspaper?**

To test the validity of this approach, consider a point-by-point look at Trudeau's decisions.

Here use the five-question process for ethical decision-making in Chapter 3 to determine if Trudeau made an ethical choice in his decision to vacation on the Aga Khan's private island. You response is anonymous and will be added to responses from other institutions using this textbook chapter.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.nscc.ca/businessfuncdn/?p=52#h5p-10

If you answer yes to any one of these five questions when considering an ethical dilemma, odds are that you're about to do something you shouldn't.

Revisiting Johnson & Johnson

As discussed earlier, Johnson & Johnson received tremendous praise for the actions taken by its CEO, James Burke, in response to the 1982 Tylenol catastrophe. However, things change. To learn how a company can destroy its good reputation, let's fast forward to 2008 and revisit J&J and its credo, which states, "We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality."[25] How could a company whose employees believed so strongly in its credo find itself under criminal and congressional investigation for a series of recalls due to defective products?[26] In a three-year period, the company recalled twenty-four products, including Children's, Infants' and Adults' Tylenol, Motrin, and Benadryl;[27] 1-Day Acuvue TruEye contact lenses sold outside the U.S.;[28] and hip replacements.[29]

Unlike the Tylenol recall, no one had died from the defective products, but customers were certainly upset to find they had purchased over-the-counter medicines for themselves and their children that were potentially contaminated with dark particles or tiny specks of metal;[30] contact lenses that contained a type of acid that caused stinging or pain when inserted in the eye;[31] and defective hip implants that required patients to undergo a second hip replacement.[32]

Who bears the responsibility for these image-damaging blunders? Two individuals who were at least partially responsible were William Weldon, CEO, and Colleen Goggins, Worldwide Chairman of J&J's Consumer Group. Weldon has been criticized for being largely invisible and publicly absent during the recalls.[33] Additionally, he admitted that he did not understand the consumer division where many of the quality control problems originated.[34] Goggins was in charge of the factories that produced many of the recalled products. She was heavily criticized by fellow employees for her excessive cost-cutting measures and her propensity to replace experienced scientists with new hires.[35] In addition, she was implicated in scheme to avoid publicly disclosing another J&J recall of a defective product.

After learning that J&J had released packets of Motrin that did not dissolve correctly, the company hired contractors to go into convenience stores and secretly buy up every pack of Motrin on the shelves. The instructions given to the contractors were the following: "You should simply 'act' like a regular customer while making these purchases. THERE MUST BE NO MENTION OF THIS BEING A RECALL OF THE PRODUCT!"[36] In May 2010, when Goggins appeared before a congressional committee investigating the "phantom recall," she testified that she was not aware of the behaviour of the contractors[37] and that she had "no knowledge of instructions to contractors involved in the phantom recall to not tell store employees what they were doing." In her September 2010 testimony to the House Committee on Oversight and Government Reform, she acknowledged that the company in fact wrote those very instructions.

Refusing to Rationalize

Despite all the good arguments in favour of doing the right thing, why do many reasonable people act unethically (at least at times)? Why do good people make bad choices? According to one study, there are four common rationalizations (excuses) for justifying misconduct:[38]

1. My behaviour isn't really illegal or immoral. Rationalizers try to convince themselves that an action is OK if it isn't downright illegal or blatantly immoral. They tend to operate in a gray area where there's no clear evidence that the action is wrong.
2. My action is in everyone's best interests. Some rationalizers tell themselves: "I know I lied to make the deal, but it'll bring in a lot of business and pay a lot of bills." They convince themselves that they're expected to act in a certain way.[39]
3. No one will find out what I've done. Here, the self-questioning comes down to "If I didn't get caught, did I really do it?" The answer is yes. There's a simple way to avoid succumbing to this rationalization: always act as if you're being watched.
4. The company will condone my action and protect me. This justification rests on a fallacy.

If you find yourself having to rationalize a decision, it's probably a bad one.

What to Do When the Light Turns Yellow

Like our five questions, some ethical problems are fairly straightforward. Others, unfortunately, are more complicated, but it will help to think of our five-question test as a set of signals that will warn you that you're facing a particularly tough decision—that you should think carefully about it and perhaps consult someone else. The situation is like approaching a traffic light. Red and green lights are easy; you know what they mean and exactly what to do. Yellow lights are trickier. Before you decide which pedal to hit, try posing our five questions. If you get a single yes, you'll almost surely be better off hitting the brake.[40]

Key Takeaways / Important Terms and Concepts

1. Business ethics is the application of ethical behaviour in a business context. Ethical (trustworthy) companies are better able to attract and keep customers, talented employees, and capital.
2. Acting ethically in business means more than just obeying laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your employer and coworkers.
3. In the business world, you'll encounter conflicts of interest: situations in which you'll have to choose between taking action that promotes your personal interest and action that favors the interest of others.
4. Corporate social responsibility refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders (owners, employees, customers, and the communities in which they conduct business) when making legal, economic, ethical, and social decisions.
5. Managers have several responsibilities: to increase the value of owners' investments through profitable operations, to provide owners and other stakeholders with accurate, reliable financial information, to safeguard the company's assets, and to handle its funds in a trustworthy manner.
6. Companies have a responsibility to pay appropriate wages and benefits, treat all workers fairly, and provide equal opportunities for all employees. In addition, they must guard workers' safety and health and to provide them with a work environment that's free from sexual harassment.
7. Consumers have certain legal rights: to use safe products, to be informed about products, to choose what to buy, and to be heard. Sellers must comply with these requirements.
8. Business people face two types of ethical challenges: ethical dilemmas and ethical decisions.
9. An ethical dilemma is a morally problematic situation in which you must choose competing and often conflicting options which do not satisfy all stakeholders.
10. An ethical decision is one in which there's a right (ethical) choice and a wrong (unethical or downright illegal) choice.

7. Electronic Commerce

Learning Objectives

By the end of the chapter, you should be able to:

1. Define Ecommerce
2. List alternative forms of Ecommerce
3. Explain the pros and cons of Ecommerce
4. Experience using an Ecommerce platform
5. Contrast Ecommerce with traditional business models

What is Ecommerce?

There are many definitions of Ecommerce but they all share a common theme. Following is a description of Ecommerce as offered by one of Canada's leading Ecommerce providers -Shopify:

Ecommerce, also known as electronic commerce or internet commerce, refers to the . Ecommerce is often used to refer to the sale of physical products online, but it can also describe any kind of commercial transaction that is facilitated through the internet.

Whereas e-business refers to all aspects of operating an online business, ecommerce refers specifically to the transaction of goods and services.

The history of ecommerce begins with the first ever online sale: on the August 11, 1994 a man sold a CD by the band Sting to his friend through his website NetMarket, an American retail platform. This is the first example of a consumer purchasing a product from a business through the World Wide Web—or "ecommerce" as we commonly know it today.[1]

Since then, ecommerce has evolved to make products easier to discover and purchase through online retailers and marketplaces. Independent freelancers, small businesses, and large corporations have all benefited from ecommerce, which enables them to sell their goods and services at a scale that was not possible with traditional offline retail.

Global retail ecommerce sales are projected to reach $27 trillion by 2020.[2]

Types of Ecommerce Models

There are four main types of ecommerce models that can describe almost every transaction that takes place between consumers and businesses.

- **Business to Consumer (B2C):**
  When a business sells a good or service to an individual consumer (e.g. You buy a pair of shoes from an online retailer).
- **Business to Business (B2B):**
  When a business sells a good or service to another business (e.g. A business sells software-as-a-service for other businesses to use)
- **Consumer to Consumer (C2C):**
  When a consumer sells a good or service to another consumer (e.g. You sell your old furniture on eBay to another consumer).
- **Consumer to Business (C2B):**
  When a consumer sells their own products or services to a business or organization (e.g. An influencer offers exposure to their online audience in exchange for a fee, or a photographer licenses their photo for a business to use).

Examples of Ecommerce[3]

Ecommerce can take on a variety of forms involving different transactional relationships between businesses and consumers, as well as different objects being exchanged as part of these transactions.

- **Retail:**
  The sale of a product by a business directly to a customer without any intermediary.
- **Wholesale:**
  The sale of products in bulk, often to a retailer that then sells them directly to consumers.
- **Dropshipping:**
  The sale of a product, which is manufactured and shipped to the consumer by a third party.
- **Crowdfunding:**
  The collection of money from consumers in advance of a product being available in order to raise the startup capital necessary to bring it to market.
- **Subscription:**
  The automatic recurring purchase of a product or service on a regular basis until the subscriber chooses to cancel.
- **Physical products:**
  Any tangible good that requires inventory to be replenished and orders to be physically shipped to customers as sales are made.
- **Digital products:**
  Downloadable digital goods, templates, and courses, or media that must be purchased for consumption or licensed for use.
- **Services:**
  A skill or set of skills provided in exchange for compensation. The service provider’s time can be purchased for a fee.

Pros and Cons of Ecommerce

There are many arguments about the pros and cons of Ecommere and they are evolving as the technology does. The following is a discussion of pros and cons of Ecommerce as provided by a leading analyst on the subject.

You don't need to be a business expert to know that e-commerce has reshaped the modern marketplace in recent years. While it's a dominant model, selling goods or services online comes with its own set of advantages and disadvantages compared to traditional brick-and-mortar businesses.

Therefore, businesses need to look beyond the hype and develop their own perspectives on the value of e-commerce. How does it help businesses and why do consumers love online shopping? It's important to explore both perspectives because advantages for consumers might end up becoming a disadvantage for e-commerce businesses. The most successful companies understand all the benefits and drawbacks well before they begin to see growing sales figures.

Advantages and Disadvantages of eCommerce[4]

By Ajeet Khurana (https://www.thebalancesmb.com/ajeet-khurana-1141298) (2019, November 20) in The Balance Small Business (https://www.thebalancesmb.com/ecommerce-pros-and-cons-1141609)

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E-Commerce Advantages

The internet might be the single most important facet of modern society. It plays a primary role in everything from political discourse and higher education to the way we conduct ourselves and our businesses. It's no wonder, then, that switching to an e-commerce model comes with significant advantages.

E-commerce eliminates the need for physical stores and allows businesses to expand their customer base. On top of eliminating the possibility of long lines, e-commerce sites offer a huge advantage to both shoppers and stores that aren't located in major urban areas. Even if you are located in a big city, e-commerce opens up new markets, allowing you to develop a new business model geared toward your expanding consumer base. Many businesses have found particular success in developing good e-commerce Search Engine Optimization, which drives more traffic to the site.

Your business can also save money on rent, utilities, maintenance, and other costs associated with physical stores. Your e-commerce store can essentially remain open 24/7 without hiring employees to watch over the store and protect items. Since you aren't confined to a set amount of shelf space, there is no limit to the number of items that can be sold online, and your store's stock can expand exponentially. Physical products will still have to be stored somewhere, but storage spaces are often cheaper than retail spaces, and you won't have to worry about factors like foot traffic and parking spaces.

Digital products can be sold online with little-to-no overhead cost. Thanks to e-commerce, consumers can purchase music, videos, or books instantaneously. Stores can now sell unlimited copies of these digital items, without having to worry about where they'll store the inventory.

E-commerce also allows your business to scale up easier than physical retailers. When a brick-and-mortar store grows, it needs to consider how it will serve more customers in the same small space. More employees are needed to expedite check-outs, more of the floor gets dedicated to forming lines, shoppers feel more crowded as customer base and inventory grows. Of course, logistics always get tougher as a business grows, no matter how the business operates. With the right choice of a third-party logistics provider, however, e-commerce companies can manage this growth without worrying about the physical store aspects.

Keeping in contact with customers is often easier for e-commerce businesses. Since the e-commerce merchant captures contact information in the form of email, sending out both automated and customized emails is simple. Let customers know about a sale, promote a new product, or just check in with customers for a personal touch—all with minimal effort. Additionally, web tools like cookies allow for superior store customization and consumer behavior analysis.

The benefits consumers enjoy are shared by e-commerce companies when it comes to the supply chain. Consumers like online shopping because they don't have to deal with cash, worry about schedules, or wait in long lines. Those benefits also apply to entire supply chains interlinked with business-to-business e-commerce systems. Procurement becomes faster, transparent, and there's no need to handle currency notes or cash. The result is cheaper, easier transactions with fewer opportunities for accounting errors.

Finally, e-commerce allows your business to track logistics, which is key to a successful e-commerce company. Having everything digitized makes it easier to automatically collect data and crunch numbers. While you can benefit from knowing what's selling best, you can also afford to take more risks on low-volume goods. The conventional retail strategy focuses on stocking fast-moving goods, but the economics of e-commerce permits slow-moving and even obsolete products to be included in the catalog. Storage is less expensive, and displaying the product is as easy as adding another item page to your site.

E-Commerce Drawbacks

While it may initially seem like e-commerce will solve all your business problems, there are disadvantages to switching from a physical location to an online store.

Many consumers still prefer the personal touch and relationships formed at a brick-and-mortar shop. This can be especially valuable to customers shopping for specialized products, as they may want to consult an expert about the best product for their needs. A solid customer service hotline can't replace face-to-face interaction with a specialized sales rep. Additionally, many customers want to experience the product before purchase, like when shopping for clothes.

Security and credit card fraud are also huge risks when dealing with online shopping. Consumers run the risk of identity fraud and similar hazards every time they enter their details into a site. If your site doesn't convince shoppers that the check-out process is secure, they could get scared out of buying. On the other hand, businesses run the risk of phishing attacks and other forms of cyberattacks. If one of your employees opens just one malicious link, it could compromise your website functionality, financial information—or worst of all, your customers' information.

If shopping is about instant gratification, then consumers are left empty-handed. They often have to either pay more for expedited shipping or wait for several days until the product arrives. The wait could drive away customers. For businesses, the shipping becomes extra complicated when a customer wants a refund. Growing e-commerce businesses need to expand their reverse logistics functions, meaning the shipping back of goods and refunding of costs.

Speaking of costs, there's a multiplicity of regulations and taxes that come with opening an e-commerce shop (and a fair amount of confusion, as well). On June 21, 2018, the U.S. Supreme Court ruled that states can charge sales tax on e-commerce transactions. But the Supreme Court left it up to states to decide what size of online retailers must pay sales tax, and what that tax rate will be. That's just one example of the regulatory confusion that has stemmed from e-commerce's rapid growth, and it doesn't even touch on international trade laws. The result is a regulatory patchwork that retailers are responsible for learning, no matter how complicated.

Good for Consumers, Bad for Businesses[5]

Some aspects of e-commerce don't fit nicely into just the pro or con side of the argument. Unique issues present an advantage to shoppers while adding difficulty for businesses. Customers might be buying, but the business could suffer in other ways.

Price comparison is a major advantage for online shoppers that can restrict businesses. Consumers can compare prices with a simple click, rather than crossing town to check another store. Many shoppers will search for the absolute lowest price, and if you can't offer it, you will probably lose the sale.

Even if you can offer lower prices, businesses who compete in these price wars will see their profits decline. Though there is nothing about e-commerce that's intrinsically tied to discounts, the way online business has evolved has led to lower prices. Buyers love the lower prices, but sellers—not so much.

Shipping is convenient for consumers, but it adds inconvenience to the business. Shoppers love having things delivered right to their doorstep, but the logistics of delivery adds substantial strain to the e-commerce business operation. The more you ship, the bigger the burden becomes. Logistics and management can become a nightmare, even as the business enjoys steady profit growth and customer retention.

Ecommerce Platforms

There are many ecommerce platforms in the marketplace today. These platforms make it easier for businesses to deliver Ecommerce to their clients. There are also many analysts each with opinions about which platform is the best and why. The following content is drawn from *The Balance Small Business*, an organization focused on exploring and advising about alternative Ecommerce platforms. It discusses three alternatives including one which will be used in this course for a key assignment where you will develop an Ecommerce site!

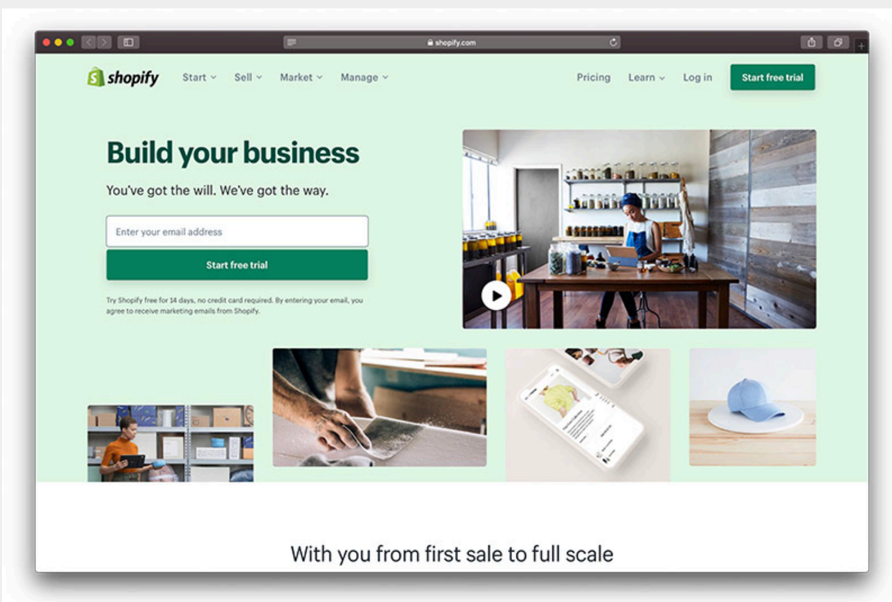
Best Ecommerce Platforms[6]

The quest to discover the **best ecommerce platform** out there has been our ongoing goal here at ecommerce-platforms.com ever since the site was established. We invest real hours each week to test and examine each platform, all in an effort to find out how viable they are among the top ecommerce platforms in the market.We're doing all this testing so that you don't have to.

The resource you're reading right now is a summary of our findings + how to pick the perfect ecommerce solution for your individual needs!

No time to read? Here's our no.1 pick when it comes to the absolute **best ecommerce platform** in the market:

Shopify (https://ecommerce-platforms.com/go/TryShopify?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart) is the most flexible, feature-rich and **the most complete ecommerce platform** of the bunch. Out the box, it already offers everything you might need to run an effective store, and also lets you customize your design and add various feature extensions.You can also sell pretty much whatever you wish, including physical products, digital products and downloads, services, and even do drop-shipping.

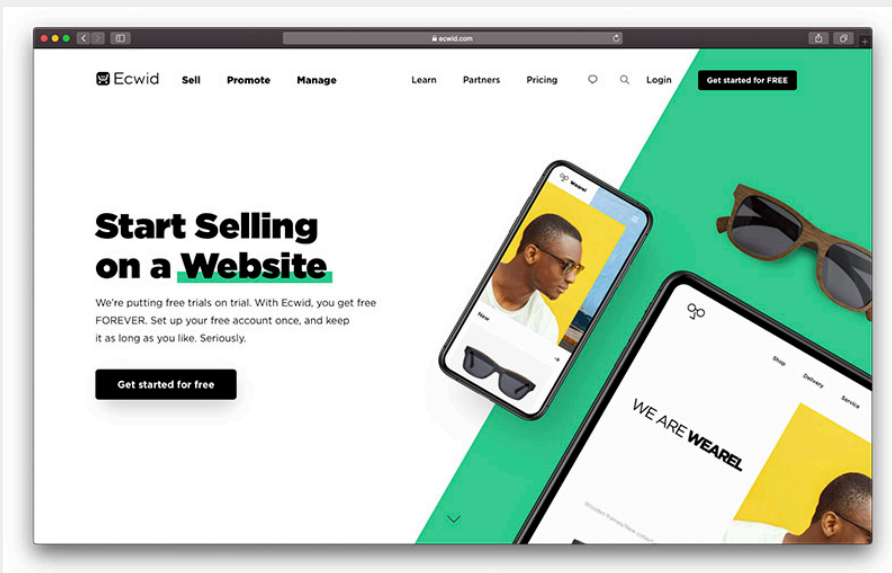


All of that starting at the price of $29 / month, or as low as $9 / month if you're okay with not having an online storefront but instead selling via social media and other channels. I wouldn't have a problem recommending this platform to anyone looking to get started in the ecommerce industry.

Overall rating: 10/10

BUDGET PICK

Ecwid (https://ecommerce-platforms.com/go/Ecwid?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart) is the only sensible free option in the market right now. Though, it's not without flaws. Chiefly, you don't get any interchangeable themes/designs for your store – you can only adjust the stock design by changing fonts, colors, etc. There's also no support on the free plan, and you can only have up to 10 products.



It might be a good place to start for some online stores. However, once your store gets off the ground and starts earning money, you're probably still better off switching to a different platform.

Overall rating: 7/10

As hard as it might be to believe, there are over 120 different shopping cart software platforms out there, and they all have their place in the market. We should know, after all, our work is to test them all out. And we've been doing that … a lot. So far, we've covered each of the top platforms in individual reviews (https://ecommerce-platforms.com/comparison-chart) plus created a comprehensive comparison chart looking through the most crucial traits of each platform. We've also ranked all platforms based on their SEO effectiveness (https://ecommerce-platforms.com/compare/best-ecommerce-platform-seo).

What you're reading here is an all-in-one summary of which is the **best ecommerce platform**, plus what makes each of the contenders great. After reading this guide, **you will know exactly how to pick the right ecommerce solution for your store.**

Here are the best ecommerce platforms that we're testing:[6]

1. Shopify (https://ecommerce-platforms.com/go/TryShopify?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)
2. BigCommerce (https://ecommerce-platforms.com/go/TryBigcommerce?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)
3. Ecwid (https://ecommerce-platforms.com/go/Ecwid?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)
4. Volusion (https://ecommerce-platforms.com/go/TryVolusion?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)
5. 3dcart (https://ecommerce-platforms.com/go/Try3dcart?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)
6. Big Cartel (https://ecommerce-platforms.com/go/TryBigcartel?utm_content=EP%2Farticles%2Ftop-6-ecommerce-platform-reviews-2012-shopify-volusion-bigcommerce-magento-bigcartel-3dcart)

Key Takeaways / Important Terms and Concepts

1. **Ecommerce** refers to the buying and selling of goods or services using the internet, and the transfer of money and data to execute these transactions..
2. There are four main types of ecommerce models that can describe almost every transaction that takes place between consumers and businesses – business to consumer (**B2C**), business to business (**B2B**), consumer to consumer (**C2C**), and consumer to business (**C2B**)
3. There are many advantages to using Ecommerce including the possibility of **eliminating the need for physical stores**, the ability to access and the ability to **reach more customers**. See the full list above.
4. There are disadvantages to using Ecommerce including **technical complexity** and **security** issues (see the full list above)
5. There are many platforms available in the marketplace today which help business adopt Ecommerce. One such platform, and a Canadian technology success story, is **Shopify**.
6. You will experience using Shopify in a kay assignment for this course!

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