

# SOLUTIONS MANUAL



# BUSINESS



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## **CHAPTER 2**

### **UNDERSTANDING THE ENVIRONMENTS OF BUSINESS**

#### **CHAPTER SYNOPSIS**

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

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

The technological environment generally includes all the ways by which firms create value for their constituents. Technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems that are used to perform business activities.

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

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

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

#### **CHAPTER OUTLINE**

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

**A. Organizational Boundaries**—These separate the organization from its environment. Today, boundaries are becoming increasingly complicated and

difficult to identify, as interactions between businesses and suppliers alter traditional roles.

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

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

A. Economic Growth—More efficient use of resources (greater output from the same inputs, or same output with fewer inputs).

1. The business cycle—The pattern of short-term expansions and contractions in an economy, with four recognizable phases: peak, recession, trough and recovery. Concepts of recession and depression are introduced.

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

3. Gross Domestic Product and GNP—Gross domestic product is the total value of all goods and services produced within a given period by a national economy through domestic factors of production, regardless of who owns the factors of production. Gross national product (GNP) refers to the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located. The Genuine Progress Indicator (GPI) is a new measure proposed by the organization called Redefining Progress, whereby the Gross domestic product is reduced by costs that result from activities that are harmful to the environment or quality of life.

a. Real growth rates—The growth rate of GDP must be adjusted to remove the effects of inflation and changes in the value of the country's currency; this is the real growth rate of an economy. If the rate of real growth of GDP exceeds the population growth rate, the standard of living improves.

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

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

d. **Purchasing Power Parity**—Exchange rates between currencies are set so that the prices of similar products in different countries are about the same. This allows for a comparison of standards of living in different countries.

4. **Productivity**—A measure of economic growth that compares how much a system produces with the resources needed to produce it. Improved productivity allows more output with the same inputs. As supply increases, prices drop, consumers can purchase more, and the standard of living improves. There are several factors that help or hinder the growth of an economic system.

a. **Balance of trade**—The economic value of all the products that a country exports minus the economic value of the products it imports. A positive balance of trade results when a country exports more than it imports. A negative balance of trade results when a country imports more than it exports. A positive balance of trade facilitates economic growth.

b. **National debt**—A country's national debt is the amount of money that it owes to creditors. A budget deficit results when government spending exceeds government revenues (primarily in the form of taxes). If accumulated spending exceeds revenues, the government borrows to make up the shortfall.

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

1. **Inflation**—The occurrence of widespread price increases throughout an economic system.

a. **Measuring inflation: The CPI**—The Consumer Price Index (CPI) measures the prices of a basket of typical products purchased by consumers.

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

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

C. Managing the Canadian Economy—The government manages the economy through both fiscal and monetary policies. Fiscal policies are government economic policies that determine how the government collects and spends its revenues. Monetary policies are government economic policies that determine the size of a nation's monetary supply, primarily through the Bank of Canada and management of interest rates. The goal of fiscal and monetary policies is to smooth out fluctuations in output and unemployment and to stabilize prices.

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

A. Research and Development (R&D)—Part of the innovation process to provide new ideas for products, services and processes. Pure research seeks new knowledge, without a particular product in mind. Applied research and development focuses on making the technological innovation into a commercial success. R & D spending in Canada makes up a lower proportion of GDP than in other countries, partly because many Canadian businesses are subsidiaries of U.S. companies and the research is being done in the U.S., not Canada.

B. Product and Service Technologies—These are the technologies employed for creating products (both physical goods and services) for customers. Technology is important in manufacturing, but it is also a significant force in the service sector. The internet is a recent technological advance affecting all businesses. Businesses must be alert to new technologies with the potential to dramatically impact their operations. Innovative use of new technology can radically alter an industry and make an existing business or industry obsolete. R& D intensity means R&D spending as a percentage of a company's sales revenue. Companies that select a competitive strategy that relies on being a leader in technology will have greater R&D intensity. It is a riskier strategy, but has the potential for significant rewards. Other companies do not want to create technological innovations, but prefer to compete on the basis of refining the technology and finding a way to be the low-cost producer of the technology, which is less risky. Cycle time refers to the length of time it takes to accomplish a recurring activity from beginning to end. Reductions in cycle times reflect increased productivity and make the businesses more competitive. Technology transfer is the process of getting new technology out of the lab and used in practical applications in the marketplace.

C. Process Technologies—Are used not so much to create products as to improve a firm's performance of internal operations (such as accounting, managing information flows, creating activity reports, and so forth). They also help create better relationships with external constituents, such as suppliers and customers. Enterprise Resource Planning (ERP) is a large-scale information system for organizing and managing a firm's processes across product lines, departments, and geographic locations. The ERP system integrates the sales process with production planning and then both of these with the financial accounting system. Internal operations are coordinated with activities by outside suppliers and customers to

improve scheduling of operations and response time needed. Real time processing allows the production of up-to-date financial reports at any time.

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

**V. The SOCIO-CULTURAL ENVIRONMENT** This includes the customs, mores, values, and demographic characteristics of the society in which an organization functions.

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

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

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

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

1. Rivalry among existing competitors—This refers to the amount of competition between businesses in an industry.
2. Threat of potential entrants—The lower the barriers to entry, the easier it is for new competitors to enter the market and influence the industry.
3. Bargaining power of suppliers—The existence of few suppliers limits the opportunities a company has to obtain the inputs it needs and provides the suppliers with strong bargaining power.
4. Bargaining power of customers—The existence of few customers when there are many suppliers provides the customers with strong bargaining power.
5. Existence of substitutes—If substitutes are readily available for the product a company sells, the industry is more competitive.

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

1. Outsourcing—The strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or resources.
2. Viral marketing—The strategy of using the Internet and word-of-mouth marketing to spread product information. Using various formats—games, contests, chat rooms, and bulletin boards—marketers encourage potential customers to try out products and tell other people about them.
3. Business Process Management—A process is any activity that adds value to some input by transforming it into an output for a customer (whether internal or external). Business process management involves creating team structures focused on processes rather than functional areas of business. By identifying those activities that are critical to the business' success, the processes that must be performed well to effectively carry out these activities, and then ensuring the necessary skills and resources are available, decision-making is faster and more customer-oriented, materials and production are better coordinated and products are delivered more rapidly.

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

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

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

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

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

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

### QUICK QUESTIONS

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



## IN-CLASS EXERCISES

### **Exercise #1—Business Accountability Handout: The Geography of Jobs**

#### **Activity Overview:**

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

**Time Limit:** 30 minutes

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

1. Make sure that students are familiar with outsourcing before you divide them into groups. Ask them to read two write-ups about outsourcing, one focusing largely on Canada, and the other on the U.S. The Canadian information is found in the Business Accountability box in Chapter 2 entitled “Is Outsourcing A Good Idea?” The U.S. information is found in italics below (make copies of this material and hand it out to students in advance).

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

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

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

*That sentiment sums up the debate nicely. On the one hand, if businesses are accountable to their shareholders, they are obligated to keep their costs as low as*

*possible and to remain competitive in their respective marketplaces. From this perspective, then, they should outsource whenever and wherever feasible. On the other hand, to the extent that businesses have a social obligation and an obligation to their current workers, they must take into account the social and human cost of displacing U.S. workers. So which side is right? This is a case in which there is no simple answer, and what is right or wrong is in the eye of the beholder.*

2. Divide students into three- or four-member groups and ask them to read the handout. Students should discuss within their groups the pros and cons of (a) outsourcing in order to keep prices down, and (b) reducing dependence on outsourcing in order to better fulfill social obligations toward stakeholders. (15 minutes)
3. Reassemble the class and discuss each group's opinions. (15 minutes)

**Don't Forget:**

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

**Wrap-Up:**

Wrap up the activity by reminding students that some industries may rely more heavily on outsourcing than others. Further, some industries gain higher-quality standards and expertise through outsourcing. Also remind students of positive trade relationships that evolve through dependence on outsourcing.

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

**Activity Overview:**

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

**Time:** 50 minutes

**What To Do:**

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

**Follow-up Questions:**

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

### **Exercise #3—Corporate Reputations: Mixed Evidence**

#### **Activity Overview:**

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

**Time Limit:** 25 minutes

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

1. Break your class into small groups and have them read Concluding Case 2-2, which is found at the end of Chapter 2. (5 minutes)
2. Assign each group one of the questions for discussion found at the end of the case study. (10 minutes)
3. After the groups have completed their respective answers, reassemble the class and discuss each question. (10 minutes)

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

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

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

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

### **TEACHING TIPS**

1. Ask students to identify current events or conditions, which may impact the success of a business today. List their answers on the board by organizational environments.
2. Have students form groups and discuss/list all the external factors (global, national, provincial or municipal) that have influenced businesses or specific businesses in their city of residence.
3. Before starting the chapter, ask students to form groups and define inflation, debt and deficit. Inform the groups that Canada's debt is nearly \$500 billion dollars. Ask them why it is important to reduce the debt and ask them to provide solutions to the problem. Students should recognize that debt is created when consumption exceeds resources. To pay down debt, consumption must be less than the resources available.
4. The following should generate a good discussion about productivity. A relevant example is typically helpful here. "If two project groups each produced a ten-page term paper by the end of a college class, but one group had six members

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

5. Ask the students when a recession becomes a depression. Have them look up various down turns in the economy on the Internet. Students may be surprised to hear that the Canadian economy has suffered more than one or two recessions over the last hundred years. Keep in mind there is no “official” benchmark on when a recession becomes a depression. Although the best answer may be from former U.S. president Harry Truman: “It’s a recession when your neighbour loses his job; it’s a depression when you lose your own.”
6. Ask students which Canadians benefit when the Canadian government incurred the annual deficits that have now grown to an accumulated deficit of nearly \$500 billion. Ask students their opinions on who should be responsible for paying down the deficit, and what impact the debt reduction will have on the economy. Does it matter whether the debt is held by Canadians or individuals and organizations outside Canada?
7. Ask students to describe the monetary policy currently in place in Canada. What does this indicate about the current state of the Canadian economy? What would be the expected change in interest rates if the government felt that the economy was slowing down and there was a strong possibility of a recession?
8. Ask students to identify current events, court rulings, or legislation which present threats or opportunities for businesses. For example, what impact does a war have on business, and why? Emphasize how something as small as uncertainty can have a major impact.
9. Ask students to describe their class. Identify the obvious demographic characteristics and also those factors, which may not be disclosed, such as, religion, sexual orientation, etc. Now speculate on how these factors might impact the decisions made by a business. Are there any opportunities? Threats?
10. Have students look up Canada’s balance of trade. Ask them about the importance of the American market. Do they see a need to diversify trading partners? Is it feasible to do that?
11. The recent trend of divestitures is in complete contrast to the policies of acquisition that characterized the 1980s. What factors might have led to this new trend?
12. Ask students to identify political events taking place in other countries and the potential impact that these events could have on Canadian businesses.
13. Ask students to identify technological innovations that have had a profound effect on an industry. There are a wide variety of examples from both the present and the past that may be discussed. Past innovations include the gas powered motor,

which allowed for the development of the automobile and the decline in businesses which manufactured wagons and carts, harnesses, etc. This also leads to the development of a network of service stations. If alternate fuel sources are successfully developed, what impact will that have on current industries? In the current environment, the development of internet capabilities has had a significant impact on many industries, including the music recording industry. What impact has the internet had on the sale of encyclopaedias?

14. Ask students to identify current events or *general* conditions which may impact the success of a business today. List their answers on the board by organizational environments.
15. Make sure that students understand that gross domestic product includes only the value of products produced within a nation's borders; the figure includes the value of products produced by both domestic and foreign companies within those borders.
16. Reinforce that gross national product includes the value of products produced by a country regardless of where they are produced; this figure does not include the value of products produced within the country by a foreign company.
17. Make sure students understand that inflation occurs when overall price levels go up because too much money is floating around; as a result, purchasing power declines.
18. Reinforce the concept that the government regulates the money supply and interest rates through monetary policy.

### **USING THE BOXED INSERTS**

#### **Opening Case: Inflation or Deflation?**

The material in the opening case deals with a very important problem. While inflation has been the concern of the Canadian government for many years, it is now possible that deflation may become an issue. There are many conflicting viewpoints on this issue, and since Canada has not been confronted with deflation in the last 50 years, there is little experience to draw on. Ask students to get the latest data on inflation and have a class discussion about why deflation has (or has not) occurred.

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

The boxed insert describes the slow process that has been evident with respect to the hydrogen fuel cell. Despite its promise, it still seems to be years away from truly widely commercial use.

### **Critical Thinking Questions**

1. Summarize in your own words the key factors that have limited the development of the hydrogen fuel cell.

These factors are clearly listed in the boxed insert. Make sure that students demonstrate a correct understanding of these factors when stating them in their own words.

2. Look at the section on new product development in Chapter 16. At what stage of the new product development process is the hydrogen fuel cell?

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

3. Consider the following statement: “The hydrogen fuel cell will never be widely used as a power source for automobiles. If the fuel cell had any value, it would have been fully developed by now and there would already be many cars on the road that are powered by the fuel cell.” Do you agree or disagree with the statement? Explain your reasoning.

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

As part of the discussion, students should be encouraged to think of products that took many years to develop before they became successful, as well as products that after many years in development never quite made it to commercialization. They should then think about the differences between these two classes of new products. The development of the automobile, radio, television, and computers are good examples of products that took a long time to develop but eventually became successful. The rotary engine is an example of a product that was in development many years, but never became widely adopted.

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

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

### **Critical Thinking Question**

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

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

### **Business Accountability: Is Outsourcing A Good Idea?**

During the last decade or so, outsourcing has become more common and more controversial. This insert examines several issues that have arisen regarding outsourcing. Some detail is presented regarding the relationship between outsourcing and the delay of bringing new products to market, and this should be of interest to students.

### **Critical Thinking Questions**

1. What is outsourcing? Why do Canadian companies outsource work?

Outsourcing is the strategy of paying suppliers and distributors to perform certain business processes, or to provide needed materials or services.

Companies outsource work because doing so allows them to focus their resources on their core activities. Outsourcing to Canadian companies keeps the jobs in Canada, but outsourcing to foreign firms means job losses in Canada in the short term. In the long term, however, outsourcing may be beneficial to Canada. Canadian manufacturers will realize cost savings when jobs are transferred to countries with low wage rates, enhancing their ability to compete in a global market. This raises Canadian productivity and improves the standard of living in Canada.

An example is given for the commercial airline manufacturing industry, showing that outsourcing may create unexpected problems. Outsourcing relations often fail within two to five years. Significant costs can be incurred when these relationships fail, particularly if the company wants to move the production back in-house. Outsourcing also means a loss of control over production.

2. Do you think that Canadian companies are treating Canadian workers unfairly when they outsource jobs to foreign countries? Defend your answer.

There are two quite divergent opinions on this issue. One view is that Canadian companies are treating workers fairly when they outsource because they are using their limited resources in the most efficient way possible. This, in turn, increases their productivity and the likelihood that they will be successful. They

will therefore hire more people and generally make a positive contribution to the Canadian economy.

The opposing view is that Canadian companies are not treating Canadian workers fairly because when they outsource work, Canadian jobs disappear overseas, unemployment increases, consumer spending declines, and the Canadian economy suffers. Both of these views have some merit. In the discussion, the focus should be on the overall impact of outsourcing and its long-term effect on the economy.

3. “Canadian companies really don’t have any alternative but to outsource. If they don’t they will not be cost-competitive and will lose out in the global market. If that happens, all Canadians will be hurt.” Do you agree or disagree with this statement? Explain.

Student answers will, of course, vary. Those agreeing with the statement will argue that free trade and the globalization of markets are good things and are the wave of the future. They will also argue that companies in other countries are constantly trying to become more efficient, and that Canadian firms have no choice but to do the same. If they don’t, Canadian firms will not be competitive in the international arena, and all Canadians will suffer. Outsourcing is a necessity in a globalized economy.

Students who disagree with the statement will express concerns about the downside of globalization, and they are also likely to place great emphasis on saving domestic jobs for Canadian workers. In the discussion it is important to emphasize the logical implications of both positions, rather than simply arguing about which position is “right.”

### **Additional Questions**

1. If outsourcing transfers jobs to low wage rate countries, what would we expect to see happening in the economies of those countries?
2. What factors might influence a company to stop outsourcing and carry out the production or service activity within its own organization again?
3. Why might companies choose to outsource a production activity to a country with higher costs than its own?

### **QUESTIONS FOR ANALYSIS**

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

Inflation is bad because it can lead to a spiral of rising wages chasing rising prices, which must rise to cover the cost of increased wages. It is good because it



can signal the beginning of a period of growth for the economy. Government tries to control inflation by adjusting interest rates through monetary policy. If the economy is strong and inflation is occurring because demand exceeds supply, a tight monetary policy can reduce demand and slow inflation and the economy to an acceptable level.

2. What are the benefits and risks of outsourcing? What, if anything, should be done about the problem of Canadian companies outsourcing jobs to foreign countries?

Benefits: reducing costs, avoiding idle capacity, availing of experts in a particular field, transferring operational responsibilities to another firm. Risks: relinquishing operational control, creating dependency, facing reliability issues, neglecting management supply chain

Students will have different opinions on whether or not something should be done. Students who want something done may recommend government actions to make outsourcing to foreign countries less desirable, such as instituting tariffs and fees on products imported into Canada. They may also recommend legislation to prohibit outsourcing to a foreign company. Students who believe that nothing should be done are likely to support their position on the grounds that businesses should have the opportunity to take their businesses wherever they like, and that government should not interfere with their opportunity to earn greater profits by utilizing outsourcing. Students may present the argument that the trend may be short term. If quality and service issues arise, the trend may reverse.

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

The environment in which the business operates has a significant effect on the operating activities of the firm and its profitability. Managers must understand the threats posed by direct competitors and companies producing substitute products or services. Managers must also understand the limitations on their business activities that arise from the political-legal environment. Managers must be aware that technological changes can alter the competitive environment very quickly, and accordingly must be monitoring the technological environment for new technology that is beneficial or detrimental to their business operations.

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

Answers will vary. Inflation measures the increase in prices of products which impacts consumer purchasing power (CPI) and other personal aspects. It indicates the required increase in earnings that must be achieved in order to maintain the existing standard of living. It is also, to a certain extent, a gauge of how well the overall economy is performing, and that has a bearing on our personal lives as well.

**Unemployment:** Information on cyclical unemployment levels may provide information on the difficulty a student may face if he or she is interested in relocating and changing jobs. Information on structural unemployment may be relevant to students who are still trying to identify what type of careers they would like to have

As a manager, information on inflation may be used when preparing a budget of expected revenues and expenses for the upcoming year. Inflation rates may be used for such things as establishing selling prices for goods and services produced, and negotiating wages and wage increases for employees. Information on unemployment levels may be used to assess the likelihood that sufficient new staff can be hired to meet the staffing needs of the company, which includes such things as replacing individuals who are retiring, or the addition of new personnel to staff new divisions.

5. Using a product or service of your choice, explain how the various environments of business impact the sales possibilities of the product or service.

Answers will vary. Using the automobile manufacturer as an example: *Political-legal environment:* will include environmental protection legislation that will set emission standards the manufacturer will have to meet in order for the automobiles produced to be sold. *Economic environment:* if the economy is strong, sales should also be strong as customers with money to spend acquire new automobiles. If the economy is weak however, sales of automobiles may decline substantially, as automobiles are durable goods with a long life, and automobile owners may decide to drive the automobiles they already own for a much longer period of time. *Socio-cultural environment:* increasingly values products that are environmentally friendly. As a result, automobiles that are not fuel-efficient may not sell well, while automobiles that run on alternative fuels may sell very well. This may also impact on the total sales volume, as some individuals will opt for public transportation rather than purchasing a car. Consumer preferences for particular colours, standard versus automatic transmission, front-wheel drive, rear wheel drive or four wheel drive, etc. will all affect which automobiles sell best. *Technological environment:* technological advances such as improved safety features may increase customer demand for some automobiles compared to other automobiles, which affects sales of particular models. Technological changes such as the manufacture of small scooters have affected the overall demand for automobiles, rather than just a preference for one particular type over another.

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

Answers will vary. There are conflicting trends today. Increased concern about global warming and environmental protection has created a trend towards increased regulation of emissions and waste. Concerns about a lessening of competition led the government to disallow the merger between the Royal Bank and the Bank of Montreal. At the same time, however, a number of industries have been deregulated, such as the airline industry.

As a manager, one would need to be aware of the entire range of regulations that are relevant to the type of operating activities carried out, as there may be limitations on the decisions that could be made. Additionally, failure to comply with regulations can result in a range of serious consequences, such as loss of licences, impositions of fines, and jail time.

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

Economic growth is desirable to increase employment, output, and wealth creation. At the same time, stability is necessary in order to have a sustainable standard of living. If inflation and unemployment are very high, consumer purchasing power is seriously eroded, and businesses have difficulty operating.

### **APPLICATION EXERCISES**

1. Select two businesses with which you have some familiarity. Identify the major elements of their environments that are most likely to affect them in important and meaningful ways.

Answers will vary.

2. Using the internet, identify the major suppliers of software for enterprise resource planning. Try to locate information about their primary customers.

Answers will vary. Suppliers that can be readily identified through an Internet search include: SAP, Oracle, Microsoft, but there are very many other suppliers as well. Students may have difficulty identifying which suppliers are major players. Students may also have difficulty identifying specific customers, but should be able to determine the types of industries that the suppliers are targeting.

3. Interview two business owners or managers. Ask them to describe for you the following things: (1) what business functions, if any, they outsource; (2) whether or not they are focusing more attention on business process management now than in the past; and (3) how the events of September 11, 2001, have affected their work.

Answers will vary.

### **BUILDING YOUR BUSINESS SKILLS**

#### **The Letdown from Environmental Upheaval**

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

“Don’t put all your eggs in one basket.” A business that has a significant volume of transactions with one customer or supplier may find that its own success is dependent on that business. When this happens, the business may find itself in severe financial difficulty in a short time and it may have serious difficulty replacing that customer/supplier. Ideally, a business should strive to have many clients so that the business is still viable if any one client ceases operations or takes its business elsewhere.

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

Again, “Don’t put all your eggs in one basket.” However, most would not have anticipated that such a major player as Enron would suddenly cease operations for any reason. Additionally, many of the businesses affected were ones that depended on providing goods and services to Enron’s employees and may not have considered themselves dependent on Enron.

3. Managers are advised to be on the alert to environmental change. Is it possible for a manager to spend too much time trying to anticipate future events? Why or why not?

Answers will vary. Anticipating and preparing for threats and opportunities arising from environmental change is a primary responsibility of managers. A manager who is very risk averse may spend too much time worrying about what might happen in the future and too little time determining the best course of action for the business when faced with these uncertainties. At the same time, a manager who makes plans without taking into consideration that those plans may change as environmental changes occur will make it difficult for the business to succeed.

## **EXERCISING YOUR ETHICS: TEAM EXERCISE**

### **Finding the Balance**

#### **Activity Overview:**

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

**Time Limit:** 35 minutes

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

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

**Don't Forget:**

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

**Wrap-Up:**

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

## CASE ANALYSES

### **Concluding Case 2-1: The Impact of the External Environment on Business Firms**

1. Describe in general terms how each element of the external environment (economic, technological, socio-cultural, political-legal, global, and business) affects business firms.

The *economic* environment has a very obvious influence on business firms. The business cycle, for example, influences the willingness and ability of consumers to purchase goods and services that companies make available. In good economic times, demand is high and companies find it relatively easy to make a profit. When an economic downturn occurs, however, consumers cut back their purchases and most firms find it much more difficult to make a profit. The *technological* environment influences the kinds of goods and services that businesses can feasibly deliver to customers. New products that are the result of R &D can make large profits for some companies while creating difficulties for other companies that are trying to market obsolete products. The *socio-cultural* environment has a very large effect on business firms because consumer preferences and tastes determine the kinds of goods and services that consumers see as desirable, and because consumer perceptions about what constitutes ethical behaviour cannot be ignored. The *political-legal* environment influences the relationship between business firms and government, and is usually seen in the restrictive legislation that is passed to control business activity. The *global* environment has a large impact on Canadian businesses because such a large proportion of production is exported. This means that Canadian products must be competitive internationally. The *business* environment contains several groups that make demands on businesses: consumers, employees, and shareholders.

The *physical* environment has become increasingly relevant for business firms as a result of the increased focus on pollution, global warming, and protecting the environment. As noted in the case, both challenges and opportunities are evident in terms of the physical environment.

2. Choose a specific industry (for example, automobile, fashion, construction, fast food, etc.) and describe how each element of the external environment is likely to affect firms in that industry.

Students will choose a variety of industries. An illustrative answer for the automobile industry might look something like this: The *economic* environment has a major impact on the automobile industry because the purchase of an automobile is a major decision for most consumers. A downturn in the business cycle and the uncertainty it creates (like the financial crisis of 2008) means that consumers are less likely to buy a new car and will instead make repairs to their current one in order to keep it running. This obviously reduces demand for new cars. The *technological* environment also has a major impact on the automobile industry because it influences the kinds of cars that are feasible to make. At present, there is much talk about electric cars, and cars powered by hydrogen fuel cells. But the technology still needs work and much uncertainty is created for both consumers and manufacturers about the time frame of development of these technologies. This makes it difficult for car makers to plan for the introduction of cars powered by these new technologies. The *socio-cultural* environment is important in its own right (it determines the strength of consumer preferences for, say, “green” cars), but it also interacts with the technological environment (consumers may want “green” cars but they may not be available because of technological problems). The *political-legal* environment has a continuing influence on car makers (for example, pollution control legislation), but on certain occasions this environment may have unusual prominence (as in 2009, when government bailouts for GM and Chrysler were given only if the car companies made certain changes to their operations). The impact of the *global* environment can also clearly be seen, as foreign car companies have become very competitive and have taken market share from domestic manufacturers like Ford, GM, and Chrysler. The *business* environment for automobiles is also relevant because consumer demands for high quality products have created intense competition among domestic and foreign car makers. Problems with mass layoffs of workers are also evident as car makers struggle to remain competitive.

3. Can managers in business firms control the elements in the external environment, or do they simply have to react to changes that are beyond their control? Give examples that support your conclusion.

Some students will argue that managers in business firms can control the elements in the external environment. They may give examples of companies that are heavily dependent on the price of commodities like oil to support their conclusion.

Other students (who may have a somewhat negative view of business) may argue that business managers do control the elements in the external environment. They may argue, for example, that advertising manipulates consumers and causes them to buy things they don’t really need.

A more insightful answer than either of the above comments is to say that while managers in business firms cannot generally control the elements in the

external environment, that does not mean that their only alternative is to react to changes. What managers can do is to do research that will either increase their understanding of trends that might be occurring, or increase their understanding of disruptive events that might occur. Strategies can then be formulated to capitalize on trends, and contingency plans can be developed to cope with disruptive events.

4. Explain how the factors in Porter’s Five Forces Model (rivalry among competitors, threat of potential entrants, suppliers, substitutes, and buyers) differ from the other environmental elements (economic, technological, socio-cultural, political-legal, and global).

The environmental elements (economic, technological, socio-cultural, political-legal, and global) are very broad in their influence. The ups and downs in the business cycle, for example, affect most business firms. While all firms are not affected in exactly the same way, all firms operate within these general environments. By contrast, the factors in Porter’s model are used to examine the competitive situation in specific industries, each of which has somewhat different characteristics.

### **Concluding Case 2-2: Corporate Reputations Are On The Line**

1. What is your opinion of the value of the rankings like these? How might the different ways the Canadian and U.S. surveys are conducted influence the results?

Student opinions about the value of rankings like these will vary. Try to determine *why* students hold the opinions they hold.

Regarding differences in the U.S. and Canadian surveys, student answers may include the following: The U.S. surveys of the general public may mean that the individuals surveyed have limited knowledge about various businesses. This may mean that the results reflect the media’s assessment of good and bad firms. The Canadian surveys of the CEOs should be tapping into a group of people who are knowledgeable about a greater number and variety of businesses. But the Canadian surveys of CEOs tap into a group of people that have a reputation as an “old boys club” and the responses may reflect preferences for firms within this network rather than an objective assessment of Canadian businesses. Students may also comment that both the survey processes are asking for opinions rather than using an objective measure.

2. Do you think the criteria that are used are appropriate? Can you suggest others?

Answers will vary, but may include the following regarding the appropriateness of criteria in the American survey:

- If you are asking members of the general public to rank companies, they may have little knowledge about the work-place environment

- It is difficult to determine the relevance of the emotional appeal of a business to its performance and whether or not it does good things for its constituents.
- Financial performance, work-place environment and social responsibility seem to be appropriate if you are measuring the business' performance and whether or not it does good things for its constituents.

For the Canadian survey:

- Long-term investment value, financial performance, corporate social responsibility, human resource management, customer service seem to be appropriate if you are measuring the business' performance and whether or not it does good things for its constituents.
- Innovation and product/service development may raise questions. Is innovation a goal in itself, or should there be an evaluation of whether the product or service innovation is one that does good things for the firm's constituents?
- Students may question how corporate governance differs from corporate social responsibility.

3. Is the ranking something that investors should rely on in buying stock?

Investors can consider the information provided by this ranking, but should not assign this data a very heavy weight in their decision-making.

4. If you were a top manager and wanted your firm to move up in the rankings, how would you proceed?

Answers will vary. The Canadian survey suggests that financial performance was still the most influential factor for the CEOs evaluating the businesses, as consumers are unhappy with service charges and interest rates, yet Royal Bank was ranked first. Managers who believed this was the case would be motivated to improve their firm's performance.

Other managers might believe that more and more consideration is given to the quality of the working environment rather than a staggering economic performance, and would choose to improve the internal environment (employee relations, working climate, internal communications) as well as the external environment (social accountability, stakeholder satisfaction). In addition, an American manager may want to find ways to receive more publicity in the media for actions he or she believes will influence the public's opinion of the business.